TECHNICAL ASSISTANCE REPORT

THE BAHAMAS

Domestic Local Currency Bond Market Development

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GLOSSARY

ABP	Annual Borrowing Plan
ACH	Automated Clearing House
BCSD	Bahamas Central Securities Depository
BGSD	Bahamas Government Securities Depository
BISX	Bahamas International Stock Exchange
BRS	The Bahamas government registered stock
CBoB	Central Bank of Bahamas
CboBA	Central Bank of Bahamas Act
CCP	Central Clearing Counterparty
CIS	Collective Investment Schemes
CSD	Central Securities Depository
DMO	Debt Management Office
FMI	Financial Market Infrastructure
FRA	Fiscal Responsibility Act
GDP	Gross Domestic Product
GMRA	Global Master Repo Agreement
HQLA	High-Quality Liquidity Asset
IFA	Investments Funds Act
IR	Investor Relations
ISIN	International Securities Identification Number
LCBM	Local Currency Bond Market
LCR	Liquidity Coverage Ratio
LMO	Liability Management Operations
MOF	Ministry of Finance
MOU	Memorandum of Understanding
MTDS	Medium-Term Debt Management Strategy
NBFI	Non-Bank Financial Institutions
OTC	Over the Counter
PD	Primary Dealer
PDMA	Public Debt Management Act
RTGS	Real-Time Gross Settlement
SOB	State-owned Bank
SOE	State-owned Enterprises
TA	Technical Assistance
TSA	Treasury Single Account
T-bills	Treasury-bills
T-bonds	Treasury bonds
T-notes	Treasury notes

PREFACE

As requested by the Ministry of Finance and Central Bank of The Bahamas (CBoB), a joint IMF-CARTAC team undertook a technical assistance mission to The Bahamas, from March 13–24, 2023, to support efforts to develop the local currency bond market.[1] The mission would like to thank the authorities for the kind, open, and collaborative discussions during the mission. The mission's main findings, summarized in this report and an annex, were presented in a wrap-up meeting with Ministry of Finance and CBoB representatives.

The mission assessed the current stage of The Bahamas' domestic sovereign debt market and formulated policy recommendations for the six building blocks included in the Guidance Note for Developing Local Currency Bond Markets.[2] In addition, the mission delivered technical presentations on topics requested by the authorities (e.g., investor relations and issuance strategies). This report highlights the key issues discussed during the mission, while an annex provides detailed results of the evaluation of each building block.

[1] The mission team comprised Trevor Lessard (IMF, Mission Chief), Gregory Horman (CARTAC LTX), Laszlo Buzas, and Bill Northfield (IMF external experts).

[2] The six building blocks consist of: (i) Money Market; (ii) Primary Market; (iii) Secondary Market; (iv) Investor Base; (v) Financial Market Infrastructure; and (vi) Legal and Regulatory Framework.

Executive Summary

Despite headwinds from the double shock of hurricane Dorian (September 2019) and the COVID–19 pandemic, The Bahamas continues with its economic and structural agenda as it strives to resume sustainable economic growth and reduce its sovereign debt levels to a more sustainable level. As part of these goals, the authorities intend to improve public financial management, develop the financial system, and rebuild economic buffers that were deployed in recent years. An integral part of this plan, included in the most recent medium-term debt strategy (MTDS), is to reorient the government's borrowing away from expensive external commercial debt, which saw a rapid rise during the last 5 years, and to once again rely primarily on the domestic market for the bulk of its financing needs.

As a result of the COVID–19 pandemic, the government increased external sovereign debt issuances, both commercial and multilateral borrowing, but with significant costs. Going forward, the authorities see domestic market development as a key ingredient in their strategy to support the rebuilding of economic buffers, support financial market development, and reorient some non-concessional external borrowing to domestic sources.

The Bahamas' overall macroeconomic policy framework is strong and conducive to the development and deepening of the domestic government bond market. The authorities' fiscal and borrowing plans are favorable to sustainably expand the domestic debt stock. While the recent global monetary tightening and ongoing uncertainty from the Russia-Ukraine war present headwinds to quickly improving the domestic government securities market, these are not insurmountable obstacles.

The mission assessed the stage of development of the six building blocks of market development. The legal and regulatory framework building block was assessed at the highest level, the "*mature*" stage, reflecting the recent progress in passing a modern public debt law, strong investor protection, and an established legal environment for collective investment schemes. The financial market infrastructure was assessed to be on the cusp between "*developing*" and "*emerging,*" reflecting strong technology platforms, including the introduction of the electronic Bahamas government securities registry (BGSD). The investor base was assessed as "*emerging,*" reflecting a strong set of heterogeneous investors (including foreign and commercial banks) and a diversified set of non-bank financial institutions (e.g., securities brokers, pension funds, insurance companies). The primary market was assessed as "*developing,*" showcasing a well-established government securities market with successful regular issuance along the yield curve, including longer-term maturities. However, the primary market exhibits some critical weaknesses, including the lack of market-determined pricing for most government securities and weaknesses in cash flow forecasting, and cash buffers, which hinder debt management. Money markets were assessed as "*nascent,*" reflecting the lack of a well-functioning short-term securities and repo market as well as some shortcomings in transparency. The secondary market was also assessed as "*nascent,*" given the lack of market trading, the fragmentation of Bahamian securities into over 200 separate instruments, and a challenging trading environment.

There is significant scope to make progress on the authorities' goal to shift funding from non-concessional external borrowing to the domestic bond market. This shift in the composition of borrowing would also facilitate the build up of a robust yield curve and increased depth in benchmark issuances.

The authorities are concerned about the possibility that measures to develop the domestic debt market may result in temporarily higher funding costs, but this should be offset with medium and longer term gains. This is a necessary investment in the process and will likely be offset in the medium-to-long term by a deeper and more liquid government securities market with lower financing costs and larger volumes. A fundamental shift will need to take place in the mindset of the authorities from a price-maker, tap-sales approach to government bonds towards a market clearing, price-taker, auction based approach. It will also be important for the authorities to ensure the fees for trading securities, especially for future trades on the BISX, are not a barrier to developing secondary market liquidity.

The recommendations in the report should be implemented sequentially. The initial phase should focus on eliminating the most critical bottlenecks, i.e., key impediments, to market development, as well as the "quick win" reforms to catalyze market development. These recommendations are largely concentrated on the primary market and investor relations building blocks. Progress in other areas, such as the secondary market, should be tackled afterwards. A challenge to developing the local market in The Bahamas includes difficulties in attracting qualified staff and lack of coordination across various stakeholders, including the MoF, CBoB and BISX. Typically, there is merit in considering the assignment of a LCBM project lead who has the authority, capacity, and support to push the process forward and encourage the various ministries and agencies to meticulously fulfill their parts of the reform plan.

Table 1. Key Recommendations

Recommendation	Responsible	Timeline	Priority
Money Markets			
Allow market foces to fully determine money market rates (¶23-24)	MoF/CBoB	ST	High
Develop stronger cash management and debt management coordination to refine money market issuance and establish a cash buffer (¶23)	MoF/Treasury/ CBoB	ST	High
Develop a repo market to support secured interbank lending (¶25-26)	CBoB/MoF	LT	Medium
Clarify legal parameters for a well functioning repo market (¶27)	CBoB/MoF	LT	Medium
Primary Markets			
Improve granularity of the ABP and the issuance calendar (delineate expected issuance across maturity buckets) to assist investors with planning (¶30)	MoF/CBoB	ST	High
Publish auction results (minimum, maximum, average prices/yields, number of bids received and accepted) immediately after having made the decision on the auction (¶35)	CBoB	ST	High
Accept market outcomes at all domestic securities issuances (¶40)	MoF	ST	High
Narrow the sales window for issuances (¶38,40)	CBoB	ST	Medium-Low
Formulate and publish rules for increasing/decreasing amount of securities issued and using a pre-determined, rules-based, range. (¶40)	MoF/CBoB	ST	High
Publish general information on the investor base for T-bills and BRS on a regular basis (¶40)	CBoB	ST	Medium
Reduce market fragmentation by eliminating the T-notes program operated by a commercial bank on behalf of the Government (¶38)	MoF/CBoB	ST	Medium
Analyze the feasibility of introducing a 30-day and 364-day T-bill tenors to replace T-notes and the 1 year BRS (¶39)	MoF/CBoB	ST	Medium
Issue all government securities by auction or syndication, rather than tap sale (¶33)	MoF/CBoB	ST	High
Reduce the number of outstanding BRS, using LMOs (¶42)	MoF/CBoB	MT	Medium
Develop an issuance policy for building up benchmark securites (¶41-42)	MoF/CBoB	ST–MT	High
Improve debt and cash management coordination and introduce a more pro-active cash buffer.(¶43)	MoF/CBoB	ST	High
Consider introduction of a treasury single account (TSA), housed at the CboB (¶44)	MoF/CBoB/ Treasury	LT	Medium
Secondary Markets			
Introduce a benchmark bond issuance policy centered around certain key tenors.(¶53)	MoF/CBoB	ST	High
Develop LMO capacity to reduce rollover and refinancing risk; conduct market outreach on the win-win aspects of LMOs (e.g. buybacks, switch auctions) (¶53)	MoF/CBoB	MT	Medium
Gradually reduce the role of CBoB from being the major market and liquidator of first resort. Develop a divestment strategy for current CBoB holdings of BRS. (¶54)	MoF/CBoB	ST–MT	High

Investor Base			
Increase Investor Relations in partnership with CBoB (¶65-67)	MoF/CBoB	ST	High
Improve existing debt management publications (e.g. quarterly debt bulletin) (¶66)	MoF/CBoB	ST	High
Craft Investor Relations strategic policy to formalize publication commitments, timetables, and consultations with market participants (¶65-66)	MoF/CBoB	ST	High
Request CBoB to consolidate data, information, and publications related to government securities into a central website portal (¶66)	MoF/CBoB	MT	High
Maintain a database of investor activity and stakeholder contacts details for analysis on investor base behavior and evolution (¶66)	MoF/CBoB	MT	High
Develop an investor relations website portal for the debt management office with links to key stakeholders, including CBoB, and BISX (¶66)	MoF	MT	Medium
Support the development of domestic investment management capacity and finance literacy (¶67,70)	MoF/CboB	MT	High
Financial Market Infrastructure			
Gather data on trade flows and trends by investor category and publish that information (¶82)	CboB	MT	Medium
Finalize plans on investor protection, repo markets, and enable over-the-counter trading (¶78)	MoF/CboB	MT	High
Consider establishing a bridge between BGSD and BCSD	CboB/BISX	MT	Medium
Legal and Regulatory Framework			
Refine the content and granularity of the medium-term debt strategy and annual borrowing plan (¶88)	MoF	ST	High
Include repo transactions as a special section in the redrafting of the Securities Industry Act (¶89,93)	MoF, CboB, Securities Commission of Bahamas	MT	Medium
Sponsor the adoption of the Global Master Repo Agreement (GMRA) to support market development (¶93)	MoF, CboB, Securities Commission of Bahamas	MT	Medium

Short-term (ST): 6–12 months; Medium-term (MT); 12–24 months. Long-term (LT): 2 years and beyond

I. Introduction

1. **The Bahamas is implementing economic and structural reforms in order to meet its development goals.** After a challenging number of years as a result of hurricane Dorian (September 2019) and the COVID–19 pandemic, the economic outlook for The Bahamas is improving and the authorities are keen to reduce the fiscal deficit and place public debt on to a more sustainable path. As part of this process, the authorities are keen to substitute expensive external borrowing with sustainable domestic borrowing to improve their debt outlook and develop the domestic market.

2. **As of end December 2022, the national debt in The Bahamas stood at B$11,426.3 million, or 90 percent of GDP**. The national debt consisted of the debt of the central government - B$11,036.4 million (or 97 percent)—and contingent liabilities—B$389.9 million of debt raised by various public institutions(e.g. the Bahamas Development Bank, Bahamas Water & Sewerage Corporation, Bridge Authority, and others).

Table 2. Debt of the Central Government as of December 31, 2022

External debt	**4 840**	**44%**
loans	*1 980*	*18%*
securities	*2 860*	*26%*
Domestic debt	**6 196**	**56%**
loans	686	*6%*
T-Bills	1 006	*9%*
Bonds	4 170	*38%*
Advances	335	*3%*
TOTAL	**11 036**	**100%**

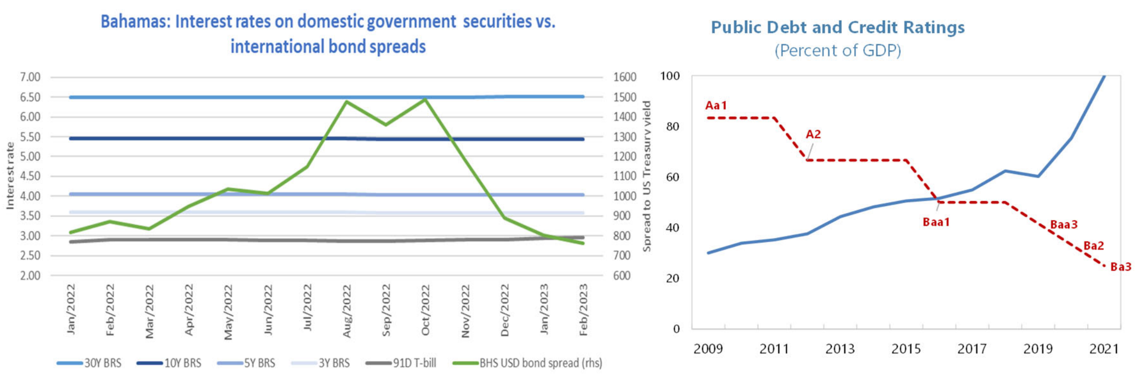
Source: Central Bank of Bahamas (CBOB)-Quarterly-Statistical-Digest. Feb-2023

3. **The debt of the central government is split 56 percent–44 percent between domestic and external debt.** The domestic debt is denominated primarily in local currency (94.6 percent) and predominantly consists of government securities (83.5 percent), while the rest is made up of loans (11.1 percent) and central bank advances (5.4 percent). Domestic securities amount to 46.9 percent of the central government's total debt portfolio (one of the criteria used by the LCBM framework to evaluate the primary markets).

4. **Going forward, the authorities intend to continue with growth-friendly fiscal consolidation in order to achieve primary surpluses and reduce public debt to below 60 percent of GDP**. As an upper-middle income country with a historically strong track record of market access, The Bahamas has traditionally been assigned an investment grade rating, but recent rating downgrades have led to a spike in external yields, which were only partially offset by an exception from capital control fees granted by the CBoB to facilitate domestic investors to purchase The Bahamas' outstanding USD external bonds (Figure 1). Domestic debt issuances have not been completely successful, with some auctions being

undersubscribed and some investors demonstrating a shift in preferences from term debt to shorter maturity instruments, especially T-bills.

Figure 1. The Bahamas: Domestic vs Foreign yields, Public Debt and Credit Ratings



Sources: MoF, CBoB, Thomson Reuters, and IMF staff calculations

5. **Despite recent challenges, The Bahamas continues to issue a meaningful amount of domestic sovereign debt across a range of maturities at relatively low interest rates.** Moreover, the authorities have been able to place benchmark securities across the yield curve, with maturities extending up to 30 years. Appetite for domestic sovereign securities is likely to stay strong going forward as organic demand from key purchasers (e.g., life insurance and pension funds) increases and there are limited alternative domestic investments available due to shallow equities and corporate debt markets as well as capital controls. Moreover, recent legislative changes, in particular the Public Debt Management Act (PDMA), present a solid base for the authorities to improve debt transparency and market outreach, which if successful should improve demand and lower borrowing rates.

6. **Of particular relevance to domestic debt market development is the recent introduction of the Bahamas Government Securities Depository (BGSD).** The BGSD is a milestone achievement that has facilitated the movement from a manual, paper based depository system to a modern electronic and automated process that greatly reduces both the time and effort required to operate. The BGSD's link to the country's real-time gross settlement (RTGS) and automatic clearing house (ACH) systems also represent a significant breakthrough to improving efficiency that bodes well for future market development.

7. **The mission assisted the authorities in assessing the stages of development of the domestic debt market in The Bahamas and formulated an action plan**. For this purpose, the mission used the recently developed LCBM framework and associated excel based tool.[3] The mission provided an assessment of the current stage of the six relevant building blocks: (i) money market, (ii) primary market, (iii) secondary market, (iv) investor base, (v) market

[3] Guidance Note for Developing Government Local Currency Bond Markets (IMF 2021)

infrastructure, and (vi) the legal and regulatory framework. Also, at the request of the authorities the mission delivered a presentation on primary market issuance strategies and investor relations. Finally, the team developed and shared with the authoriites a draft technical assistance (TA) memorandum that, subject to the authorities' agreement, could form the basis of a structured IMF/CARTAC engagement with The Bahamas in the area of local government securities development (see Annex II).

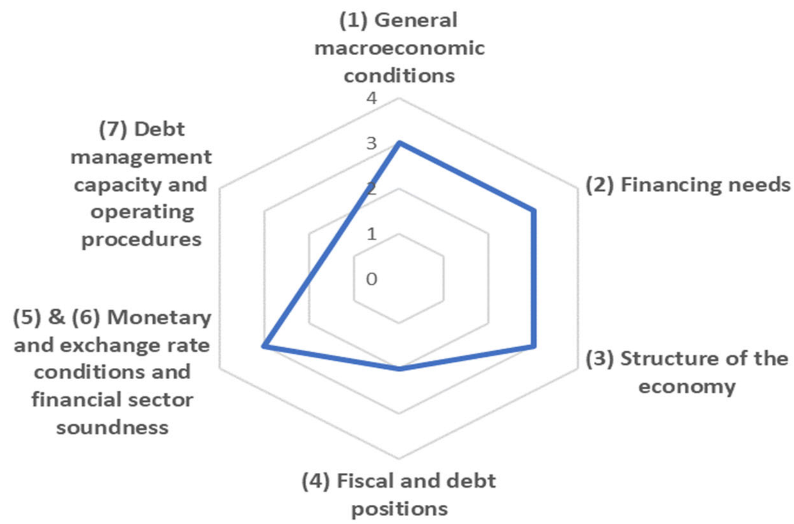
8. **The report is structured as follows**: The next section details the assessment of the six building blocks and policy recommendations for each of the building blocks, while section III presents concluding remarks. Annex I provides a detailed discussion of each building block as well as some of the results that underpin the scoring for each building block.

II. Assessing the Stage of Development of the Domestic Debt Market

A. Enabling Conditions – Overview

9. **The Bahamas is well placed for the implementation of policies that may deepen the level of market development**. The country has maintained in recent years a track-record of sound macroeconomic performance. Although the combined shocks of hurricane Dorian and the COVID-19 pandemic caused the economy to contract by 23.8 percent in 2020, growth rebounded by 13.7 percent in 2021 and continued to expand by 11.0 percent in 2022. Growth is projected to decelerate to 4.3 percent in 2023 and trend toward 1.5 percent in subsequent years. In addition, the country has avoided severe adverse financial shocks, such as debt restructuring and a banking sector crisis. Even though the government aims to take advantage of concessional resources that are available from development partners, meeting financing needs will require market-based domestic borrowing. Moreover, the government intends to increase reliance on domestic financing and longer-dated debt and to reduce the shares of foreign-currency and short-dated debt over time.

Building Block Figure 1. Enabling Conditions



Sources: MoF, CBoB, and IMF staff calculations

10. **The Bahamas' public debt is assessed as sustainable but vulnerable to shocks.** Central government debt was 89.4 percent of GDP at the end of 2022, after peaking at 103.3 percent of GDP in the previous year. The debt level is expected to decline over the medium term to 81.7 percent in 2028, as the authorities work towards reducing central government debt to the target of 50 percent of GDP by 2031 set in the Fiscal Responsibility Act. There are many risks around the baseline debt path, related to the implementation of the planned fiscal consolidation, the persistence of inflationary pressures, potential increases in borrowing costs both domestically and externally, and susceptibility to climate shocks such as hurricanes. Gross financing needs will remain significant over the medium term, despite an expected decline from approximately 25 percent of GDP in 2022 to 19 percent of GDP in 2027. Government gross financing needs are not expected to be an obstacle to local market development as commercial debt issuance is expected to shift from external to domestic sources.

11. **The financial sector is characterized by a large and heterogenous set of actors, providing a diversified set of investors on which to build a thriving domestic debt market.** These include domestic and foreign-owned commercial banks, broker-dealers, collective investment schemes, pension funds, general and life insurance companies, and some households; non-resident participation in the domestic market is negligible. Domestic investors display a range of preferences in terms of the maturities of securities. Recently some financial institutions have reduced the duration of their exposures or have limited their take-up of new securities because of internally imposed credit exposure limits or concerns about sovereign risk.

12. **Monetary and exchange-rate conditions are conducive to market development.** Following global trends, inflation reached 5.6 percent in 2022 but is projected to fall below 3 percent by 2025 and remain low and stable. Some market participants expect inflation to persist or rise, given the large import content of consumption and tourism. The long-standing exchange-rate peg remains credible, supported by the commitment of the CBoB, high levels of international reserves that are projected to remain adequate over the medium term, long-standing and effective capital flow measures (even with the modest relaxation through the reduction of the premium charged on buy and sell rates in the investment currency market), and a real effective exchange rate that is assessed as only slightly overvalued. The CBoB has significant capacity to carry out its functions, and its governance and autonomy were strengthened through the new Central Bank of The Bahamas Act (2020).

13. **With respect to institutional arrangements, a debt management office (DMO) has been established within the Ministry of Finance (MoF), though it remains understaffed and lacks the capacity to conduct most debt management functions**. Under the Public Debt Management Act, debt management operations are the responsibility of the DMO and encompass front, middle, and back-office functions. In the interim, while capacity in the DMO is being built, the MoF continues to rely heavily on the CBoB to perform many functions as its agent, including front-office tasks related to issuance of treasury bills (T-bills) and The Bahamas government registered stock (BRS) (i.e., government bonds), payment of debt service, debt recording, and compilation of statistics and other information on government securities. The MoF and the CBoB are drafting a memorandum of understanding to govern the principal-agent relationship related to debt management functions.

14. **The DMO, however, has begun to perform some middle-office tasks.** The Public Debt Management Act requires the DMO to develop and publish a debt management strategy that establishes the roadmap to achieve the objectives of public debt management for the upcoming budget year and at least two subsequent financial years. The strategy is approved by the government. The strategy was first released in December 2021 and then updated in December 2022. Consistent with good practice, the update included an evaluation of actual borrowing in 2021/22 versus the annual borrowing plan that had been announced for the year.

Recommendations

15. **Developing the capacity of the DMO will be a medium-term process, involving the recruitment, training, and retention of staff with appropriate and specialized skills not currently available within the MoF.** The level of MoF salaries is a key obstacle to staffing the DMO. While a solution to the problem of remuneration is being sought, the MoF should explore modalities such as receiving secondments of staff from the CBoB and hiring private-sector professionals on non-permanent consulting contracts. Those modalities would

also assist in the training of staff who may be hired externally or transferred from elsewhere in the MoF to the DMO.

16. **There is scope for materially improving the conduct of debt management over both the short and medium-to-long term to increase the credibility, and effectiveness of the authorities' debt management activities**. In the immediate future, it will be important to improve coordination between the MoF and the CBoB and to include the MoF in the regular market consultations related to government financing that are currently undertaken by the CBoB alone. Increased exposure of MoF staff to CBoB funding operations and market participants will facilitate skills transfer as well as sensitize the issuer to current market conditions.

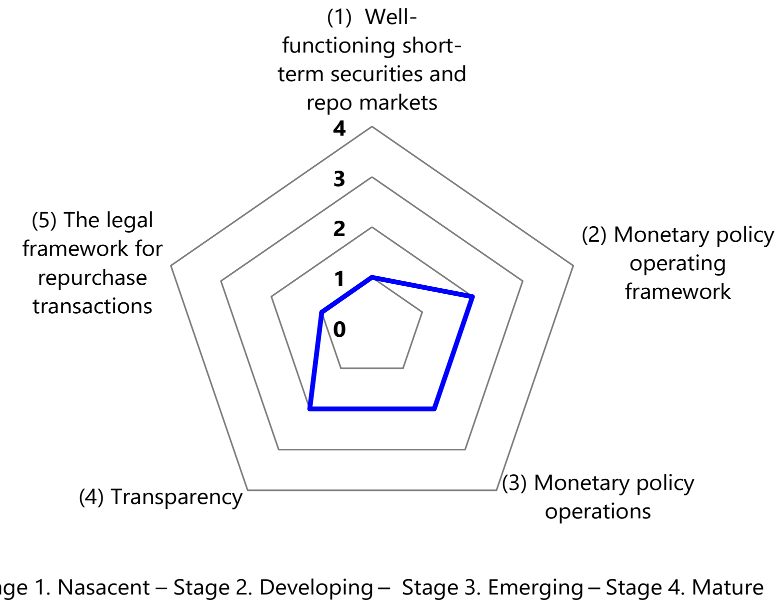
17. **Coordination of debt and cash management should be strengthened.** Responsibility for cash management rests with the Treasury department of the MoF. The Treasury prepares forecasts of above-the-line and below-the-line cash flows based on inputs from the Budget department, other MoF units, and the CBoB, along with its own analysis of historical trends. The forecasts are updated during the year to take account of actual outturns and unforeseen expenditures. The reliability of forecasts over a multi-month horizon is not strong. A treasury single account is in place, but there is no target for the cash balance. There is a sustained reliance on the overdraft facility and advances from the CBoB, while arrears on payments to suppliers sometimes accumulate. These factors pose impediments for the formulation and the orderly execution of the annual borrowing plan.

B. Money Markets

Assessment

18. **Based on the LCBM framework, the money market in The Bahamas is assessed at stage 1.6 ("nascent").** The outcome indicator of "a well-functioning short-term securities and repo market" is assessed at stage 1.0, reflecting the lack of interbank trading and absence of a repo market. Meanwhile, policy indicators relating to the monetary policy framework and monetary policy operations are assessed at stage 2.0, reflecting the lack of open market operations and repo market activity, the authorities' tendency to cap T-bill rates and limited transparency on secondary market trading activity.

Building Block Figure 2. Money Market

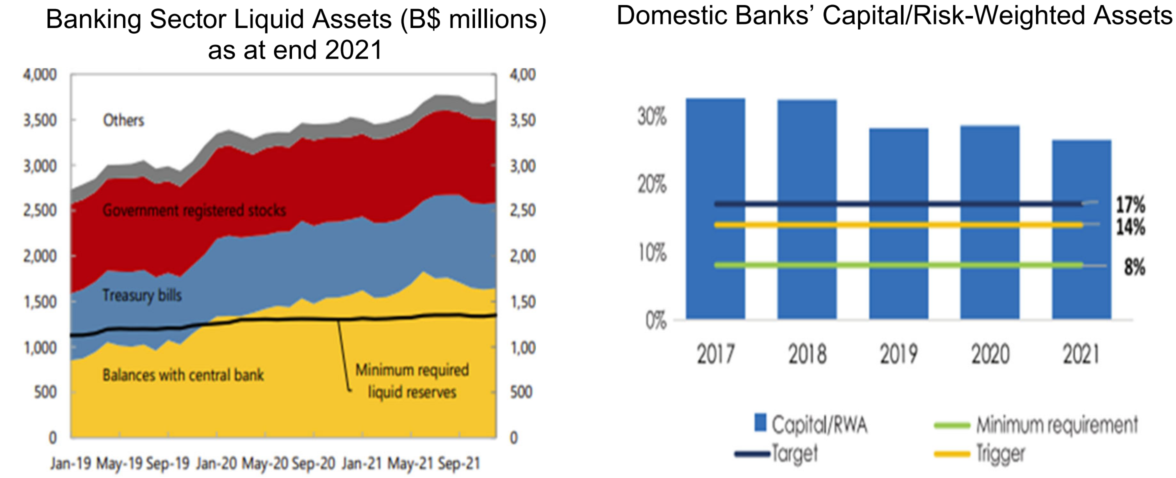


Sources: MoF, CBoB, and IMF staff calculations

19. **Monetary policy in The Bahamas operates under an exchange rate peg with binding capital controls.** There is no explicit inflation target and monetary policy operations are lagging. Capital controls facilitate some degree of monetary policy autonomy, yet the domestic policy rate has remained constant at 4 percent since May 2017. Commercial banks' prime rate has been set at 4.25 percent since 2017 as well. Monetary transmission is poor. The CBoB has two strategies to manage domestic liquidity: (i) changes to reserve requirements, and (ii) sales or purchases of government stock with end investors, from its own stock of government securities. Some years ago, the CBoB used credit controls to limit inflation, such as hard caps on loan-to-value ratios, but the CBoB has not actioned these for several years.

20. **The market currently operates under conditions of surplus liquidity.** The elevated levels of bank liquidity reflect an environment of sustained weakness in credit demand and the cautious lending stance maintained by commercial banks, trends visible since the twin shocks of Hurricane Dorian in 2019 and the COVID-19 pandemic. Financial stability concerns remain muted, as banks' average capital levels have stayed well in excess of the regulatory target, trigger and minimum capital ratios of 17.0 percent, 14.0 percent and 8.0 percent respectively. The average capital adequacy ratio for the sector stood at 26.4 percent at end-2021 (Figure 2).

Figure 2. The Bahamas: Domestic Banking Sector



Source: IMF and CBoB.

21. **Surplus liquidity is common across the range of non-bank financial institutions**. Insurance companies have benefited from positive premium growth rates over the past seven years. Public corporations, mutual fund and pension fund managers also report healthy liquidity, with investment in BRS driven in part by the lack of fixed income or equity alternatives. However, liquidity forecasting techniques are still developing and a deeper understanding of liquidity trends, complemented by more active use of short-term liquidity management tools like repos, will contribute to market development.

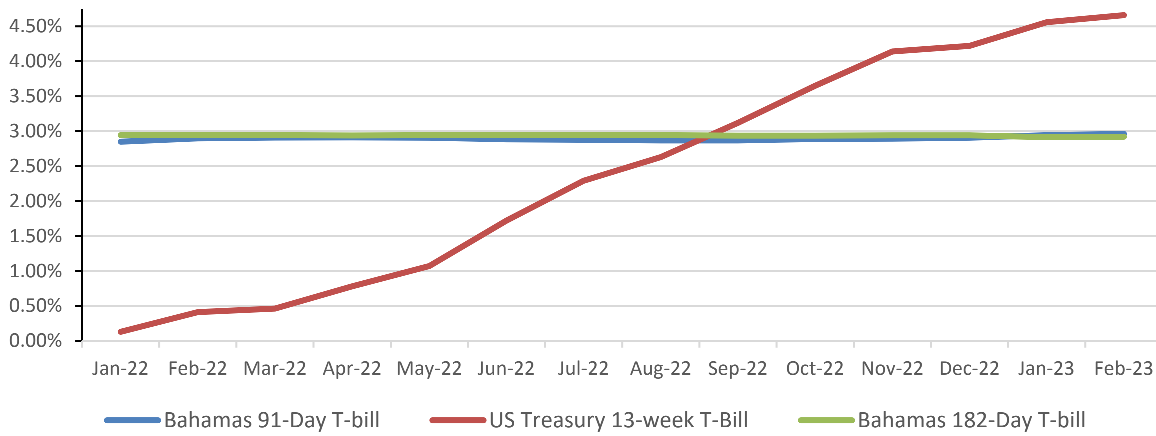
22. **Reserve requirements are the main instrument for regulating banking sector liquidity, while interest rates play a limited role.** Most T-bill issuances are straight-forward rollovers of maturing lines, not absorbing new cash from the markets. A few unscheduled T-bill auctions are held periodically, but these are driven by government short-term cash flow requirements rather than timed to sterilize private sector liquidity and have had a negative effect on market perception. Currently, the CBoB relies on the cash reserve requirement ratio (CRR), for managing liquidity.[4]

23. **In the money market, a short-term yield curve is developing via T-bill issuance.** Currently the CBoB issues 91-day and 182-day T-bills on a schedule driven by redemption of outstanding T-bills. While prices are nominally set by market demand, the issuer has demonstrated price sensitivity in accepting some bids, resulting in a few undersubscribed auctions. While the transparency and content of T-bill auction announcements and results are respected, the nearly unchanged pricing of T-bills over the past fifteen months, during a period of rising core interest rates globally, has undermined the authorities' credibility and

[4] To manage structural liquidity in the banking system, the CBoB relies on the CRR which require banks to maintain in a blocked account with the CBoB a given ratio of their deposits with customers. In April 2021, the CRR was decreased from 10 to 7 percent, in order to provide liquidity to the banking system.

the value which local institutions place on T-bill rates as short-term money market benchmarks. Figure 3 provides a historical comparison of Bahamian T-bill pricing and 13-week U.S. government T-bills. Further, while there is no reported seasonality in government cash flow requirements, T-bill issuance amounts have varied from B$91 million (June 2021) to B$492 million (January 2022), providing irregular and lumpy issuance events that undermine the value of the clearing rate as the cost of clearing an average running volume from month to month.

Figure 3. The Bahamas: Historical T-Bill Borrowing Costs Compared to US 13-week T-Bill Costs,
2022 to February 2023



Sources: CBoB and U.S. Treasury.

24. **Market participants are open to an expansion of money market instruments.** Several counterparts with whom the mission met expressed an interest in 30-day T-bills as a more flexible liquidity management tool. Others commented that issuing the 1-year Treasury Note as a discounted 360-day T-bill priced via competitive auction would provide a valuable additional price reference for short-term interest rates. The introduction of two new money market lines will provide additional flexibility for the monetary authorities, should the need arise to manage domestic liquidity more actively at some point.

25. **There is no interbank repo market.** While The Bahamas has a small and controlled capital market, the use of repo could be positive for market development, and some of the pre-conditions required for market development are becoming more visible. For example, the new BGSD system will support repo trading and settlement, and leading banks regularly express to the CBoB their interest in repo activity and their willingness to consider interbank trading. Further, more NBFI are moving into T-bills to reduce gap risk on longer-dated BRS prices, bringing together investors with different investment motivations, which is a key pre-condition to enhancing market activity.

26. **Current structural excess liquidity reduces the urgency to develop repo markets in the near term.** However, prudent debt management suggests that leading market counterparts should now lay the groundwork for future repo trading. For example, the use of repo transactions in central bank market operations is a good starting point to catalyze the money market development process. Repo markets could also strengthen the capacity of banks and other institutional investors to adjust their liquidity positions and invest in longer-term government securities and, at a later stage, help to support dealer activities in the primary market.

27. **For the further development of the money market, adoption of the standardized GMRA is a precondition.** The lack of a clear and tested legal framework is mentioned by banks as one factor that hinders their willingness to prepare for future repo trading. For example, local counterparts will need certainty on the legal treatment and enforceability of ISDA contracts in domestic courts.

28. **The CBoB is best placed to take responsibility for promoting money market development.** Repo is a complex instrument and specialized knowledge is required on many levels, from execution and risk management to settlement. Some banks also commented on the need for capacity building on repos and liquidity management strategies. Repo market progress requires parallel development of both money and capital markets. It also needs a robust legal framework and supporting prudential regulation. Finally, it needs efficient trading and settlement infrastructure. In the development process, many different actors are involved, starting with the interbank market makers through security dealers, asset managers, custodians, industry associations and regulators, to Parliament and the courts. Usually, the central bank is in the best position to take up the responsibility of promoting reforms and coordinating between this wide range of parties.

Recommendations

Phase 1 (6 to 12 months)

- Allow market forces to fully determine short-term money market rates (e.g., T-bill prices)
- Develop and sponsor repo market development, as a means of secured interbank lending, and as a vital cornerstone of money market activity.
- Develop stronger debt and cash management coordination and communication to refine money market issuance.

Phase 2 (12 to 24 months)

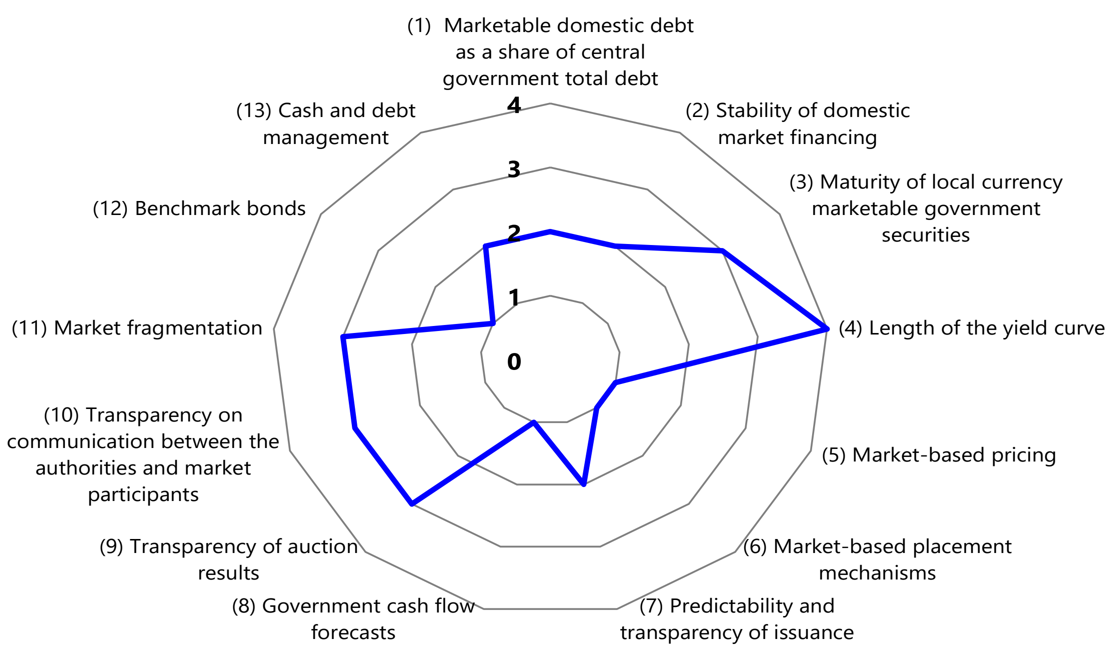
- Sponsor development of reference rate for interbank markets
- Clarify the legal standing and enforceability of repo contracts (e.g., GMRA) via revisions to the Bankruptcy Law or a Law on financial collateral.

C. Primary Markets

Assessment

29. **Under the LCBM framework, the primary market for domestic government securities in The Bahamas is assessed as being at stage 2.4 ("developing").** The score is supported by the scheduled issuance of government securities to a diversified domestic investor base, purchasing securities across a long-term yield curve, resulting in an ATM of 6.9 years. However, the absence of a market-based placement mechanism for BRS and the lack of benchmark building policies, as well as challenges between debt and cash management and the transparency surrounding debt management strategy development and implementation keep this building block at the developing stage.

Building Block 3 Figure. Primary Market



Stage 1. Nasacent – Stage 2. Developing – Stage 3. Emerging – Stage 4. Mature

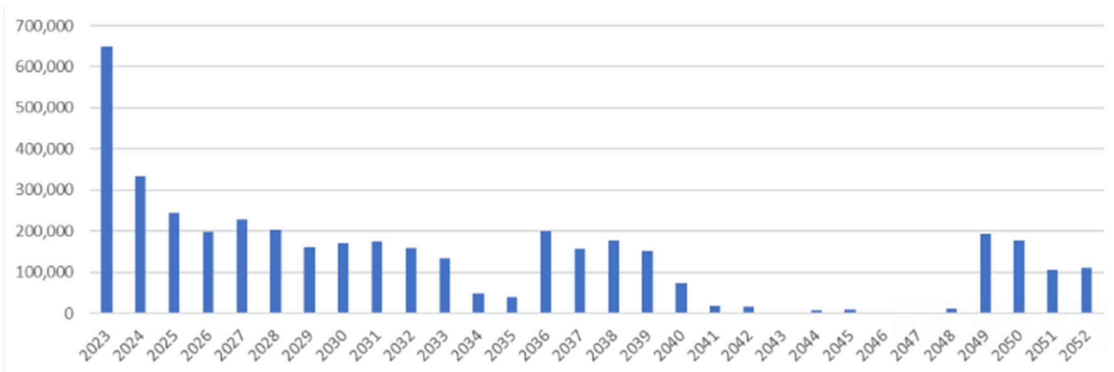
Sources: MoF, CBoB, and IMF staff calculations

30. **Issuance of domestic government securities takes place according to the MTDS, ABP and an annual issuance calendar published in advance of each fiscal year.** The current objective is to increase the share of domestic debt while maintaining its present positive features (i.e., relatively long ATM and low ATR). The 2023 ABP would benefit from more detailed information on the planned issuance of government securities, segregated by maturity buckets (e.g., Treasury bills, short-dated bonds (1–4 years), medium-dated bonds (5 to 12 years) and long bonds (for 13 years and longer)) and an indication of the volumes to

expect from each bucket. The current issuance calendar gives information on the aggregate issuance amount, but not the various tenors to be offered.

31. **The Bahamas benefits greatly from a long yield-curve and a manageable maturity profile.** Redemptions are well distributed without any significant bunching of maturities. The current average time-to-rollover of the domestic debt is 5.5 years.

Figure 4. The Bahamas: Maturity Profile of the Domestic Debt (B$ 000s)



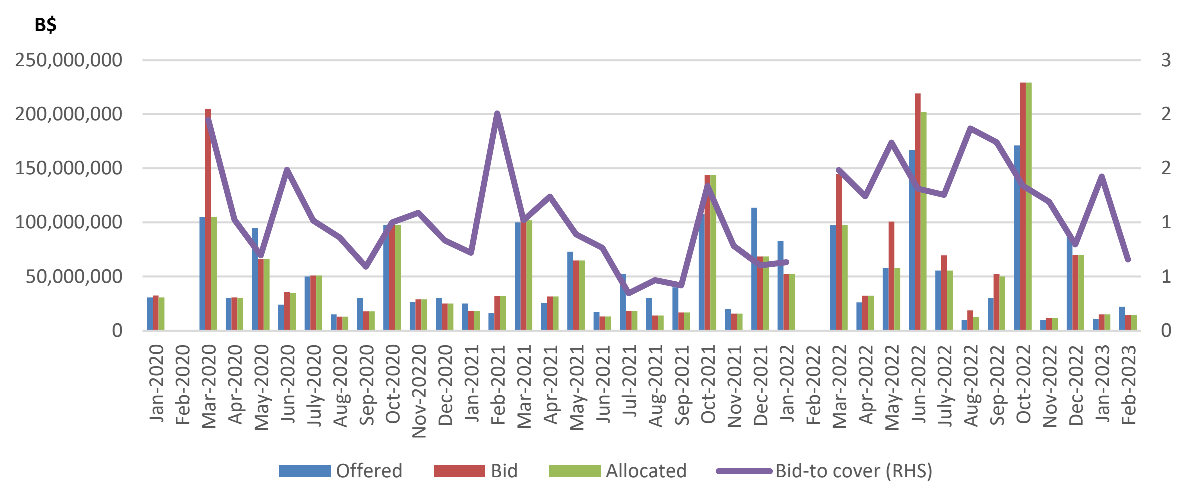
Source: CBoB.

32. **At the end of 2022, there were 240 BRS lines outstanding, a clear indication that a benchmark bond issuance policy does not exist.** The BRS can be reopened several times following an initial public offering (IPO), but there is no target size for securities; outstanding notional amounts can vary between B$100,000–500,000 and B$167 million. Introduction of a benchmark issuance policy, accompanied by Liability Management Operations (LMOs) aimed at consolidating smaller securities into larger and therefore more liquid bond lines (e.g., one long-term line maturing in any given year instead of a multiple number of smaller issues), could form a strong base to support primary market demand and secondary market development

33. **Only a portion of domestic government securities are issued via a marked-based mechanism.** While T-Bills are offered at competitive multiple-price auctions, longer-term BRS securities are placed as a tap issue. All prices for each tap are set at par, with the corresponding coupon rate determined by the issuer (MoF) upon consultation with the CBoB. The authorities do not regularly canvass market risk appetite prior to each monthly sale, while the pricing methodology and rationale is not published. Market participants may place bids only with regard to volume, as the system would not accept any bids that differ from the predetermined par price. As a result, new-issue yield movements have been limited in recent years, irrespective of volatile rate movements globally. Price discovery bears little relation to underlying rate markets and lack credibility. As a result of some investor mistrust of the issuer's opaque pricing rationale, a significant share of tap sales have been uncovered during the past three years (Figure 5).

34. **In an environment where prices are not readily available, market expectation of the required yields could be tested via syndications.** This is a market-based placement mechanism that enables the issuer and investors to reach consensus on a clearing price (yield) at which a new issue would be fully subscribed. Syndications could be used during the initial placement of a new line, and increased by consecutive re-openings held at competitive auction, when the market already knows that the initial price of the security has been narrowed by market forces, not pre-set by the issuer. The price negotiated at the initial offering then could then serve as a reference for investors, and increasing the bond over time to benchmark size would be easier in view of the integrity of the initial price being set by market demand. While letting the market set the price of BRS may result in higher yields initially, this strategy should mobilize greater liquidity over the medium to long term, and support financing the budget in a more predictable manner, which should be a priority for public debt management.

Figure 5. The Bahamas: Registered Stock Placement 2020–2023 to Date



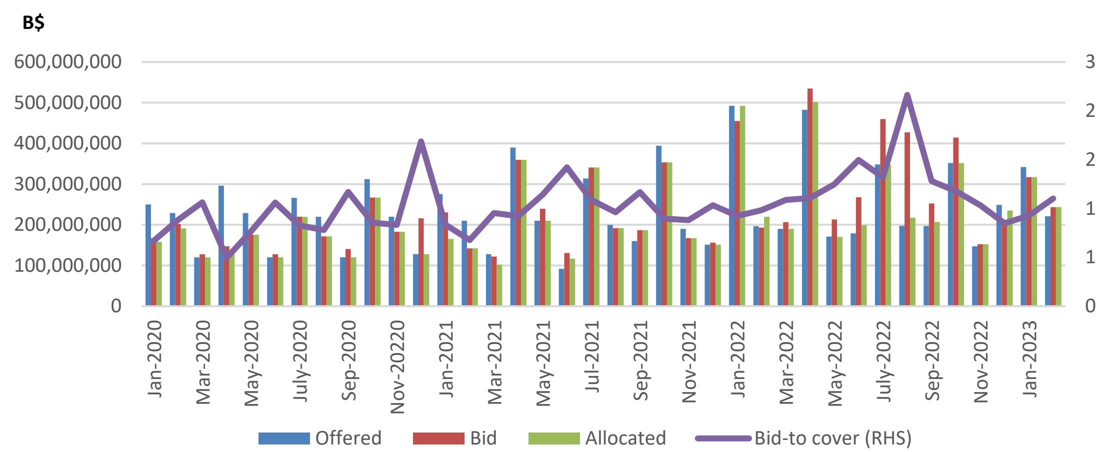
Source: MoF.

35. **Participation in the tap issues is open to all investor classes.** According to the rules and procedures described in the prospectus published one week prior to the auction date, IPOs will no longer prioritize bids for "individual" investors who subscribe for up to B$250,000. Instead, the bid allocation process will consider (i) the bid value, (ii) the total value of all valid bids, and (iii) the total offering amount. Bidders now may apply via an online application portal managed by the CBoB to submit their bids. The digitization of the subscription process has been welcomed by the market for the greater efficiency the automated order processing and settlement provided. Orders are required to be pre-funded electronically via a commercial bank or by using the Sand Dollar (the CBoB's digital currency).

36. **In principle, allocations are made on a pro-rata basis across all bidders, but in some cases when tenders are oversubscribed, very low-value bids are less likely to receive allocations.** Each security offered may grow or shrink, at the discretion of the issuer and commensurate with demand. However, no insights on the decision-making process that leads to grow or shrink the final notional amount are shared with market participants. Settlement takes place on the second business after the closing date and unsuccessful bidders receive refunds of pre-deposits within two to four business days following the settlement date.

37. **T-Bills are issued via a competitive auction process carried out by the CBoB as agent for the government.** During the past 14 months (January 2022 to February 2023) amounts offered at the monthly auctions varied between B$129 million and B$492 million, making primary T-bill placements quite lumpy. Notwithstanding, only four auctions were undersubscribed during this period, and the aggregate accepted amount was above the total targeted/offered amount (B$3,844.5 million vs. B$3,764.5 million, respectively).

Figure 6. The Bahamas: T-Bill Issuance 2020–2023



Sources: MoF, CBoB, and IMF staff calculations.

38. **Participation at primary T-bill auctions is open to all investors; however, as bids are now submitted electronically, investors not having access to the Bahamas Government Securities Depository (BGSD) must submit their bids via a dealer-broker.** Bids of B$500,000 and over are treated as competitive bids, while bids below B$500,000 are treated as non-competitive bids. Non-competitive bids may be allocated following the initial tender and based on availability at the average tender price.[5] Announcement of the auction takes place 7 days before the opening of the auction, while the window to present bids into the auction itself runs from 9:00 a.m. to 3:00 p.m.. Each security on offer can grow or shrink

[5] Former rules, giving individuals a preferential treatment, have been abolished.

based on the total volume of bids received and, if more lines are auctioned, the entire offer also can grow or shrink at the discretion of the issuer. Successful participants usually receive a confirmation on the first business day following the tender.[6] Settlement of the auction takes place on a "T+2" basis. As non-BGSD participant bidders are required to pre-deposit (prefund) the bids, unsuccessful bidders may wait for the refund until settlement date.

39. **T-bills are issued with tenors of 91 and 182 days while fixed-rate BRS are offered across the yield-curve, starting with maturities ranging from 1 year up to 30 years.** Though not unique, the 1-year note is somewhat atypical, and could be easily replaced by a more traditional 364-day T-bill. T-bill issuance could also benefit from the introduction of a 30-day instrument, further complementing the liquidity management tools of the banking sector and strengthening the liquidity management options for the Treasury.

40. **Market risk embedded in the government securities issuance process could be reduced through reforms.** First, the subscription window is open for six hours, which is considerably longer than common international practice and exposes participants to interest rate volatility during the subscription period. Second, allowing market forces to determine clearing rates for BRS supply would instill greater confidence in the issuance process. Third, the shrink or grow option for managing issuance creates uncertainty around the final issuance amount which may be reduced by setting limits to applying the option (e.g., plus or minus ten or fifteen percent of the announced target notional). Fourth, publication of the various investor categories purchasing government securities would increase awareness of the breadth of the market appetite in different maturity buckets, and help disseminate information about liquidity.

41. **The lack of a benchmark building policy is hindering market development efforts**. Currently, there is no policy to build benchmark lines that would concentrate issuance on a smaller number of bonds that could be deemed "the" benchmark in key tenors. Despite some re-openings, most BRS lines are small in size. The domestic market will remain fragmented until there are fewer BRS lines outstanding. The increased size of benchmark BRS lines could also attract wider investor participation, owing to increased perceptions of liquidity in the benchmark, and make it easier to find interested buyers or sellers in the secondary market.

42. **Liability management operations could assist the authorities to lessen fragmentation of the BRS market.** Buybacks and exchange/switch auctions could consolidate the large number of outstanding bonds into a smaller number of larger benchmark securities and help manage future rollover risk inherent to the issuance of

[6] In the absence of a liquid government securities market and stable underlying rate environment, this delay does not seem to bother market participants.

benchmark size securities. LMOs are quite common in the practice of public debt managers, but some market consultation and education would be useful before actual deployment.

43. **Unexpected cash management shortfalls in The Bahamas point to an opportunity to improve the cash management's resilience to unforeseen expenditures without having recourse to special auctions, which are detrimental to market development**. Streamlining the access of line ministries, agencies and SOE's to liquidate buffers and conducting self-evaluation in order to find out what makes forecasts unreliable would improve the credibility of forecasts and increase efficiency of cash management. That said, most important would be to develop a sufficiently large cash buffer, via the issuance to government securities, to enable the cash managers to operate from a position of strength and security.

44. **Cash management could have a jump start with the introduction of more proactive cash management practices, including repos and a cash buffer for the Treasury**. Advances and overdrafts should be viewed as last-resort funding. T-Bill issuance should move away from the simple rollover of maturing securities and become a dynamic source of raising liquidity from the market.

Recommendations

Phase 1 (6 to 12 months)

- Provide more information in the ABP and the Issuance calendar (delineate expected issuance across maturity buckets) to assist investors with planning their investments.
- Publish auction details (minimum, maximum and average prices/yields, number of bids received and accepted) immediately after finalizing the auction decision.
- Accept market outcomes for all domestic securities issuances (e.g., be a price taker across the curve)
- Narrow the sales time for issuance to reduce exposure to market risk.
- Formulate and publish rules or criteria for applying the shrink/grow option on issuances.
- Publish general information on the investor base for T-Bill and BRS issues on a regular basis.
- Analyze the feasibility of introducing 30-day and 364-day tenors to the T-Bill issuance calendar to improve liquidity management of banks and the Treasury.

Phase 2 (12 to 24 months)

- Ensure that prices for existing securities reflect changes in the underlying rates environment and interest accrual.
- Reduce the number of outstanding BRS ISINs and increase the size of benchmark BRS ISINs.

(i) with regards to existing debt, deploy LMO strategies (buybacks and exchange/switch auctions);
(ii) when issuing new BRS, offer into a single ISIN in each benchmark tenor for a longer period via reopenings, until it reaches the targeted benchmark size.

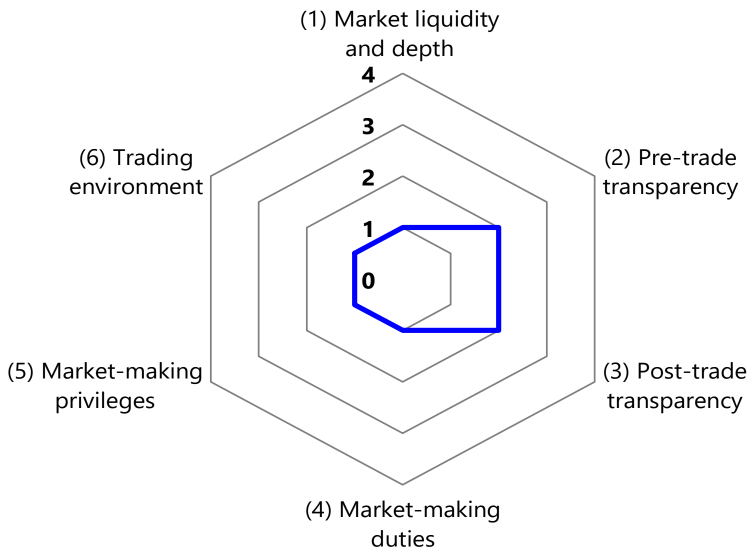
- Develop LMO capacities for market maintenance and refinancing risk management purposes. Buybacks and exchange/switch auctions could help manage future rollover risk inherent to the issuance of benchmark size securities.
- Improve debt and cash coordination, cash management, and build a larger cash buffer
- Adopt a more pro-active cash management structure.
- Move to a treasury single account located at the CBoB from a domestic bank with zero remuneration.

D. Secondary Markets

Assessment

45. **The secondary market for government securities in The Bahamas is assessed at stage 1.2 ("nascent").** This score applies to both the outcome and policy indicators, scoring 1.0 and 1.4 respectively. The overall low score for this building block reflects the lack of secondary market activity, which is due to the challenges stemming from primary markets issuance practices, the lack of competing investable assets and the capital controls in place. Secondary markets are also hindered by the buy-and-hold behavior of the investor base.

Building Block Figure 4. Secondary Market



Stage 1. Nasacent – Stage 2. Developing – Stage 3. Emerging – Stage 4. Mature

Sources: MoF, CBoB, and IMF staff calculations

46. **Secondary market development requires meeting some key preconditions.** These include (i) an efficient money market, particularly visible in an active interbank repo market, (ii) predictable and transparent issuance of a small number of benchmark securities representing a range of different tenors and placed at market clearing prices in the primary market, (iii) a sufficient number of intermediaries (primary dealers/market makers) trading non-negligible amounts of securities with standard pricing during agreed times; (iv) investors with different investment profiles (cost-risk preferences) including some investors open to trading; (v) efficient market infrastructure; and (v) a supportive legal and regulatory environment (e.g., tax systems). As a consequence, secondary market development is extremely dependent on the level of development of other building blocks and, as a rule, takes place with a time-lag.

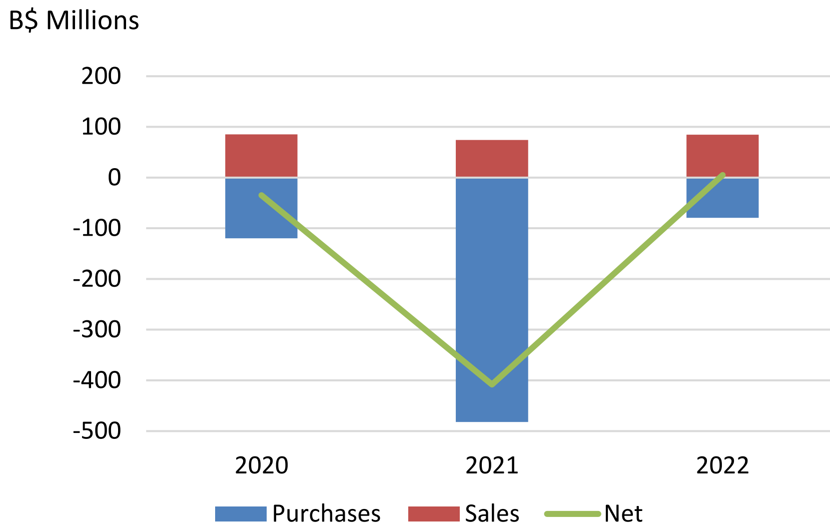
47. **In the traditional sense the secondary market in The Bahamas is non-existent.** A hold-to-maturity culture exists among both institutional and retail participants, as several of the preconditions outlined above are not present. However, two types of activities are, rightly or wrongly, accounted by the authorities as secondary market trades: (i) allocation of government securities for non-competitive bids, and (ii) a buyback/sale window operated by the CBoB for the purposes to provide early redemption option to investors. While general information on the former is released in relation to a primary market sales, no information is provided by the CBoB with respect to that latter and its market-making activities (see below).

48. **Non-competitive bids, i.e., bids submitted for the auctions with a value less than B$500,000 may be accepted if the offered amount is not sold during the competitive auction.** In this case the remaining amount may be offered to interested investors at the "market-based weighted average price" of the auction. This is viewed by the authorities as a secondary market "offering" as investors need to contact the issuer expressing their interest.

49. **In the absence of a "true" secondary market, investors in government securities may find it difficult to sell their holdings before maturity.** Offers may be placed on the BISX and after a certain period (usually 2–3 days) if no counterparty is found, the seller may turn to the CBoB to buy the relevant security. The CBoB regularly publishes prices on which it is ready to trade BRS with market participants. The bid-offer spread quoted for any security is set at 5 cents across the curve, regardless of maturity. A private sector market maker would find it challenging to replicate these narrow spreads or quote tighter pricing and still make a profit and reasonable return on capital required to support the trading balance sheet.

50. **The CBoB pricelist is valid for one month, after which a new pricelist is published.** The reason for such market-making activity by the central bank is to maintain investor confidence in government bonds, i.e., if needed, a holder will find a counterpart to exit its investment and redeem the bond early. But a result of having this facility is that the CBoB accumulates government securities on its balance sheet and, from time to time, it needs to offer securities via auctions in the secondary market for prudential balance sheet management purposes.

Figure 7. CBoB Purchases and Sales in the Secondary Market 2020–2022



Source:CBoB.

51. **In 2022 the CBoB attempted to withdraw from providing public brokerage services but faced significant pressure from the investment community to restore the securities.** The CBoB reversed its decision and continues to provide liquidity to market participants. This fact raises several questions:

(i) There is parallel issuance of government securities in the market. While at present, it is executed in a coordinated manner, in the future there may be conflicts if the MOF were to need funding during a CBoB operation.

(ii) Instead of being a market maker, the CBoB should provide a backstop for private sector market makers (e.g., broker dealers, if in the future the MoF cannot assume this role).

(iii) It may be prudent to proceed with caution. In conditions of excess liquidity and with limited reinvestment alternatives, investors wishing to sell government securities may not be able to find a buyer if the central bank stops providing the service. It may be advisable to adopt a strategy to lower gradually the strength of the CBoB's market-making commitment, such as by widening the bid-ask spread on the price sheets and differentiating the spread across maturity buckets.

52. **As government securities are listed on the BISX, according to the Securities Industry Act (SIA) they cannot be traded outside the Exchange.** This creates a serious impediment for developing an OTC market for government securities. Many countries use their respective stock exchanges simply for trade reporting purposes, i.e., OTC trades have to be reported and settled via the stock exchange and the exchange subsequently publishes

trading activity on a regular basis. Arrangements in The Bahamas may have some practical reasons (the modern infrastructure, connectivity with the BGSD operated by the CBoB), but sometimes these arrangements serve as financial support for the exchange and its participants (brokers), who receive (the same) fees for reporting the trades concluded OTC.

53. **The large number of government securities outstanding creates an illiquid and fragmented market**. Given the lack of a benchmark bond policy, it is not reasonable to expect that one or more financial institutions would assume the role of a market maker for all government securities. Efforts should be taken to consolidate the outstanding 240 BRS lines into fewer (20-30) benchmark lines by using LMOs. The consolidation of the outstanding debt could help stimulate secondary market trades in other bonds as well.

54. **If the current setup were to be maintained, any potential market maker will face competition from the CBoB's brokerage operations.** If there is an intention to develop secondary markets, the CBoB should withdraw from its current role as the price-leader (i.e., tightest bid-offer spread) for two-way trading in government securities and act more as a "lender of last resort" or a backstop for market makers.

55. **Repurchase agreements are also needed to enhance secondary market liquidity, as their use may create demand for government securities as collateral.** In countries with more develop debt markets, the authorities have created a Securities Lending Facility (SLF) to provide a backstop for securities to help dealers avoid potential settlement failures. Access to these facilities may be costly and only available for short periods, as a means to instill discipline into trading practices and to avoid crowding out the interbank market.

Recommendations

Phase 1 (6 to 12 months)

- Introduce a benchmark bond policy that can play a fundamental role in starting the secondary market – step by step.

Phase 2 (12 to 24 months)

- Develop capacities and train staff to conduct LMOs (buybacks and switches) in order to consolidate the large number of government securities into fewer benchmark lines. Smaller lines may be bought back completely, larger series maturing in the same year could be offered a switch into one of these bonds, and new issuances should rely more on re-openings and building larger, more liquid bond lines in key tenors.

- Clarify roles of the MOF and the CBoB as market makers in government securities. The MOF as issuer should take the role of backstop bidder using the CBoB as agent.

Phase 3 (beyond 2 years)

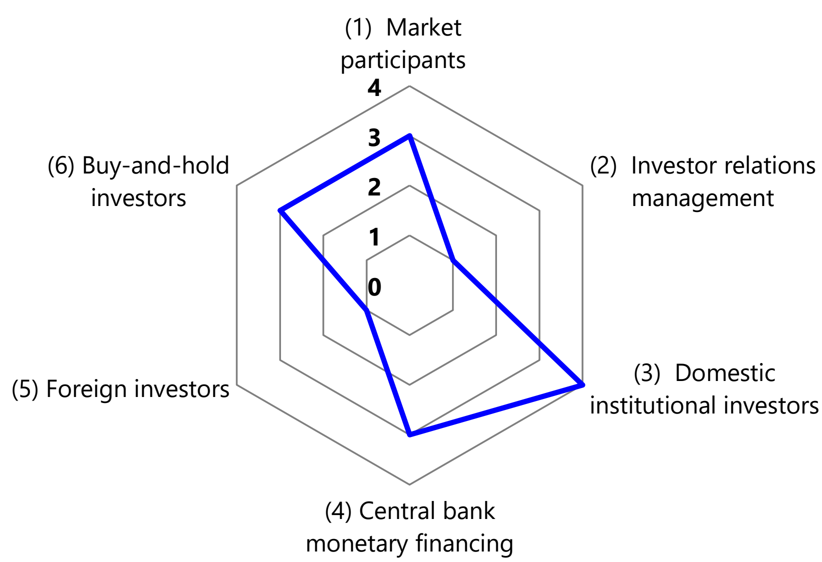
- Gradually reduce the role of CBoB from a major market maker to a last resort liquidity provider in government securities (as an Agent for MOF).
- Develop repurchase agreements to enhance secondary market liquidity.

E. Investor Base

Assessment

56. **The investor base for government securities in The Bahamas is assessed at stage 3.0 ("emerging")**. The outcome indicator is largely due to the depth and diversity of the non-banking sector and the broad range of market participants. The policies and practices indicators suggest that significant work is needed to bolster investor relations management with the predominantly buy-and-hold domestic investor base.

Building Block Figure 5. Investor Base



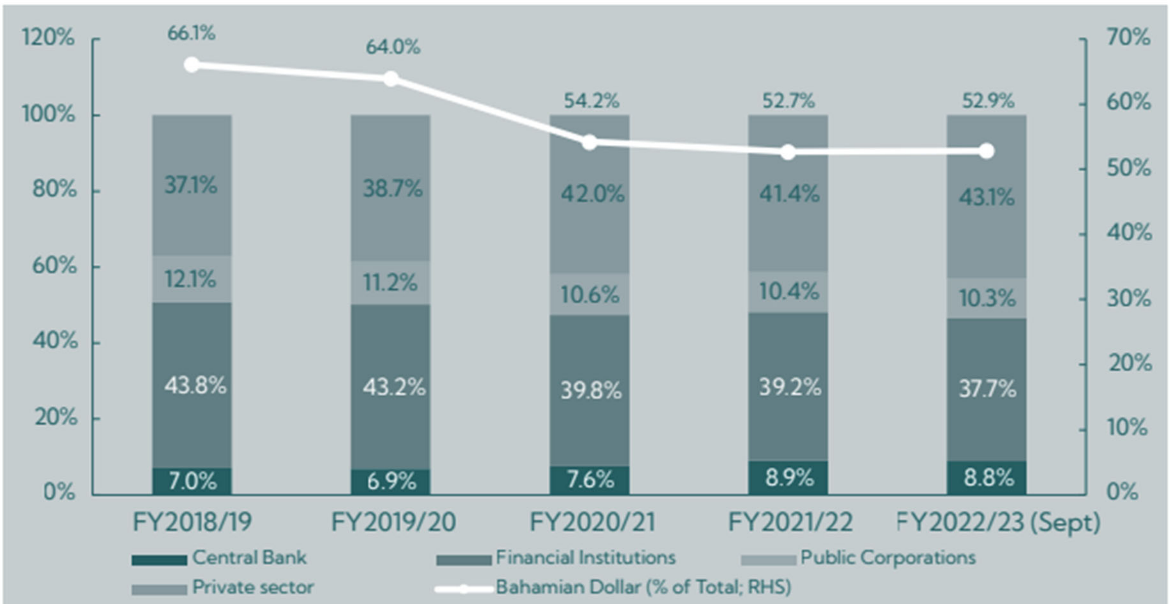
Stage 1. Nasacent – Stage 2. Developing – Stage 3. Emerging – Stage 4. Mature

Sources: MoF, CBoB, and IMF staff calculations

57. **The Bahamas' relatively diversified investor base supports demand for government securities across various maturities, strengthening the resilience of the funding strategy at times of market stress.** For example, as some domestic banks with majority foreign ownership lowered exposure to Bahamian government securities after Hurricane Dorian and the COVID-19 pandemic, local institutions offset this trend and increased their holdings of government debt (Figure 8). The development of a diverse

investor base comprising agents with different investment horizons and risk-return preferences, particularly institutional investors, allows the government to spread risk across its debt portfolio and helps to extend the yield curve. The absolute size of the domestic financial sector largely defines the domestic absorption capacity for government bonds, and the structure of the financial sector can have a significant impact on market liquidity.

Figure 8. The Bahamas: Holders of Local Government Debt (percent)

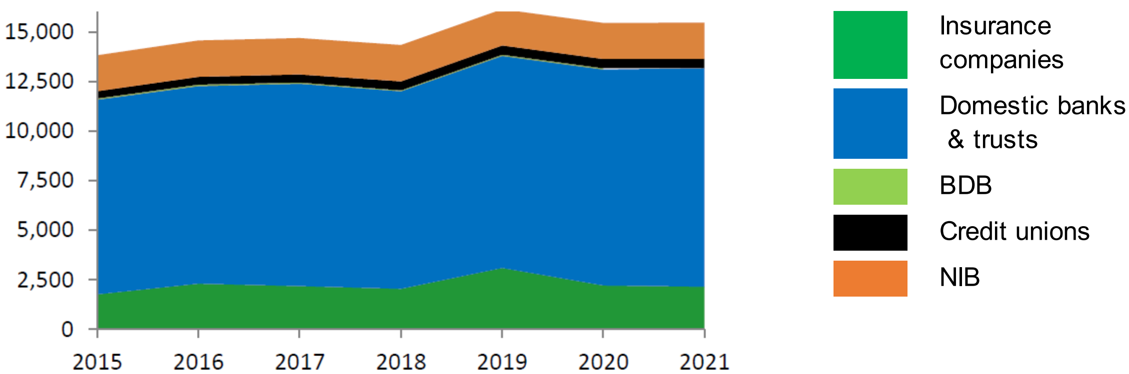


Source: Ministry of Finance.

Market Participants

58. **While liquidity in the financial system is abundant, the lack of alternative investment opportunities leads many investors to hold bonds to maturity.** The scale of non-bank financial institutions (NBFI) is reasonably large, and spread across institutions in the mutual funds, insurance and pension fund sectors. Demand from these investors for long-dated assets to match long-dated liabilities provides support for the MoF to extend the maturity of government securities.

Figure 9. Assets of Domestic Financial Institutions (B$ million)



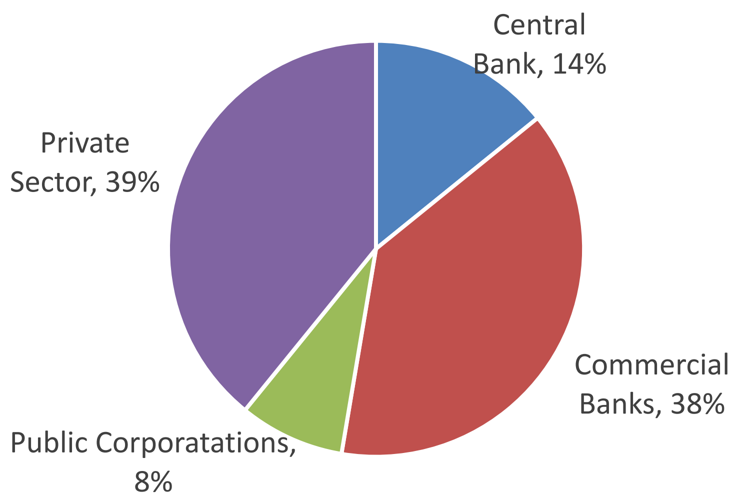
Source: Central Bank of The Bahamas Financial Stability Report 2021.

Depth and Diversity of the Banking Sector

59. **The domestic banking system includes 17 banks (3 domestic majority owned banks, 4 foreign bank subsidiaries and 10 credit unions).** The Bahamas has adopted Basel III regulations and bank demand for government securities is driven in part by their HQLA status. Bank holdings of government securities had traditionally concentrated on the short to intermediate tenors (up to 7 years), but since the COVID-19 pandemic some institutions started shortening duration exposure to the government. This has been visible among the foreign banking subsidiaries that are restricted by country credit limits and were more affected by Bahamas credit rating downgrades. As a result, the foreign banking subsidiaries are either more heavily invested in T-bills or allowing their positions to roll off at maturity into cash holdings.

60. **Government securities holdings are spread evenly across the banking sector and NBFI.** The central bank estimates that commercial banks and NBFIs hold 38 and 39 percent, respectively, of domestic government debt.

Figure 10. The Bahamas: Public Sector Debt by Creditor Type at Dec-2022 (percent)



Sources: MoF, CBoB, and IMF staff calculations

Depth and Diversity of the Non-banking Sector

61. **Total assets of NBFIs are equivalent to about 43 percent of GDP.** The sector is dominated by mutual funds and the National Insurance Board (NIB) accounting for some 60 percent of all NBFI assets. Insurance companies and other financial institutions (such as microlenders) are the other NBFIs. Money-market mutual funds (CIS) are present as an alternative to deposits. Their government securities holdings are invested in both T-bills and BRS.[7]

62. **The insurance sector is diversified across long-term (12 companies with assets of B$ 1.56 billion; 13 percent of GDP) and general insurance providers (19 firms with assets of B$ 590 million; 4.5 percent of GDP).** Long term insurers demand longer term debt; 53 percent of long-term insurer assets are held in government securities. However, there are no regulations requiring insurance company portfolios to hold a minimum share of government securities. The majority of general insurance investments are held in cash and term deposit accounts (52 percent) to provide ready liquidity if needed; government securities holdings represent only 18 percent of general insurance assets.

63. **The pension fund sector is dominated by NIB.** Pension fund coverage in The Bahamas is limited; however, the authorities estimate that only 20 to 25 percent of residents are covered by some form of retirement plan. The NIB is a funded state pension plan that had total assets of B$1.8 billion (nearly 13 percent of GDP) at end-2019. The bulk (86.4 percent)

[7] The largest position in CFAL's money market fund is a T-Bill (15.3 percent of assets), while the next four largest securities holdings are all BRS with less than three years to maturity (26.1 percent).

of NIB's fixed income investment at end-2019 was in local government securiites, spread out across T-Bills (0.2 percent), T-Notes (0.6 percent) and BRS (85.6 percent). There is no regulatory minimum requirement nor maximum limit on pension fund holdings of domestic government securities.

64. **Both public and private pension fund portfolios are managed either externally by private asset managers, or by in-house portfolio managers.** Bond portfolio investments typically aim to cover future liabilities, which supports a modicum of investment in local government bonds. Data on private pension plan investments is not readily available.

Investor Relations (IR) Management

65. **No formal IR policy, strategy or IR management unit exists to improve the transparency of debt management operations.** Capacity within the DMO is hampered by small number of staff in the unit whose work is not aligned across a front/middle/back office organizational structure. While the CBoB works with the Meridian debt recording system, periodic reports on the country's debt portfolio are not published, and are not easily located. The MoF has limited information about its investor base and the DMO does not maintain a database of investor contact details. Having a formaland well structured IR function allows the issuer to assess market conditions, understand investor preferences and potentially mitigate risks in distressed periods. IR strategies are critical for establishing an issuer's credibility.[8]

66. **The MoF does not maintain a dedicated website on debt management operations.** While several key policy documents (e.g., an MTDS report and Annual Borrowing Plan) are available, debt management in The Bahamas would benefit from strategy implementation, the government debt portfolio and more dissemination of benchmark issuance policies. Further, the location of publications on government websites is not well-signposted; they are difficult to locate which undermines their value for market participants. For example, the quarterly debt statistics bulletin is located within the budget section of the MoF website. The CBoB's website contains information related to government securities auctions, yet those seeking the local capital markets must access multiple websites across multiple agencies (e.g., the CBoB, the MoF, the Securities Commission, the Insurance Commission and the BSIX). Further, the CBoB website does not offer linkages or signposts the availability of key publications included on the MoF website.

67. **Most of interactions with the local financial community on government debt methods is led by the CBoB.** The MoF has recently started to become more involved in these discussions and needs to obtain more first-hand exposure to the end buyers of their debt. However, local investors comment that interactions with the CBoB and MoF are not

[8] A recent IMF report by Knight and Northfield covers this topic in detail: "*Sovereign Investor Relations: From Principles to Practice*" IMF Working Paper 20/204.

held on a regularly scheduled basis, either bilaterally or in a group format. Bilateral and group meetings with local investors can provide both the forum at which guidance is offered on future debt management operations, and the opportunity for stakeholders to share their views on market dynamics and trends in risk appetite.

Central Bank Monetary Financing

68. **While the CBoB is prohibited from purchasing government securities in the primary markets**, **temporary advances to the government are allowed within circumscribed limits.** The MoF may obtain temporary advances from the CBoB for a limited period if certain Temporary Loan Capacity and Primary Market Capacity conditions are met. Interest on advances is based on the 91-day T-bill rate. Periodical recourse to this window reflects shortcomings in short-term debt and cash cash flow management. At the same time, the CBoB is currently the primary provider of liquidity for government securities on the secondary market. All secondary market purchases are counted towards the CBoB's prudential exposure limits to the central government. In the course of purchasing government paper in the secondary market, the CBoB often comes up against this prudential limit. This pressures the CBoB's capacity to extend further advances, and any CBoB-managed sales of its portfolio positions may require discounting to find buyers, resulting in losses for the CBoB's trading book.

Foreign Investors

69. **Foreign investor participation in the domestic government securities market is negligible.** Existing capital controls limit timely access to BRS and T-bills. Government securities do not carry IOSCO-recognized ISINs and no clearing bridge exist between the BGSD and international clearing and settlement bodies. Further, the low rates offered in the domestic market reduces the attractiveness of local market investment.

Buy-and-hold Investors

70. **A fixed income trading and investment culture has yet to develop in The Bahamas, reflecting the country's preference for keeping interest rates fixed for prlonged periods of time.** The lack of a vibrant corporate bond market or a liquid equities market also contribute to restrain trading. Investments in real estate and other fixed assets are visible, yet these instruments are also purchased with a long-term investment horizon. The lack of income or capital gains taxes in the country removes tax considerations as a potential impediment to trading activity. However, local investors noted that both retail and institutional end investors lack financial literacy and do not always understand the credit, liquidity or market risks involved in in the investment process.

Recommendations

Phase 1 (6 to 12 months)

- Develop IR capacity in partnership with the CBoB and jointly engage with the financial community.
- Refine and reposition the quarterly statistical report or develop a more succinct, standalone, quarterly debt bulletin (QDB).
- Craft IR strategy policy that formalizes publication commitments, timetables and consultation fora with market participants.
- Request the CBoB to consolidate data, information and publications related to government securities into a central portal.
- Leverage database of stakeholder contact details to enable the dissemination of IR materials and the tracking and targeted analysis of investment behavior
- Ensure key policy documents and debt management publications are regularly updated, fit for purpose, easily located, and distributed on a timely basis to domestic and external stakeholders.

Phase 2 (12 to 24 months)

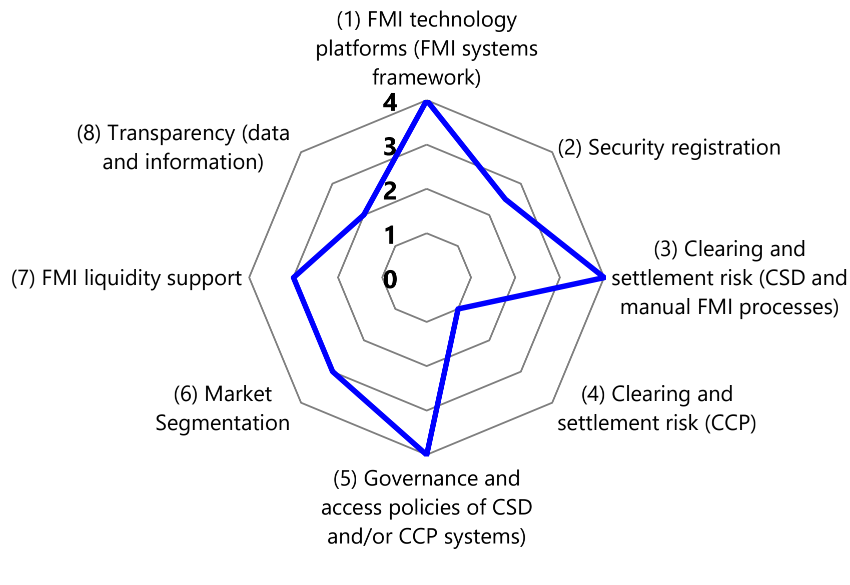
- Develop a DMO's IR website portal with links to the CBoB's various data, statistics and information on government securities.
- Support efforts to improve financial literacy

F. Financial Market Infrastructure

Assessment

71. **In terms of the LCBM Framework, The Bahamas' Financial Market Infrastructure (FMI) is assessed to be at stage 2.3 ("developing").** This score mainly reflects the existing technology platforms that handle security registration, clearing and settlement of the fully dematerialized government securities. However, currently The Bahamas has two CSDs: one for government securities owned by the CBoB that has only recently adopted automated processes, and another CSD (the BCSD) operated by BISX for corporate securities and equities.

Building Block Figure 6. Financial Market Infrastructure



Sources: MoF, CBoB, and IMF staff calculations

72. **An efficient FMI is an important precondition of market development.** Systems used in settlement and clearing of financial transactions should be safe, cost efficient and convenient to use. The FMI framework should include systems necessary for the issuance (auction), settlement, registration and custody of securities, and payment systems for cash settlement.

73. **Within the LCBM development framework, the FMI is evaluated alongside five dimensions.** These are: (i) electronic platforms; (ii) efficient and low-risk custody and settlement; (iii) soundness and operating environment of FMI, (iv) repo markets; (v) transparency in the money, primary and secondary markets.

74. **The systems should be interconnected and provide for straight-through processing in order to minimize counterparty and market risk during clearing and settlement.** In this respect, dematerialized securities, delivery versus payment, electronic link to the central bank's Real-Time Gross Settlement (RTGS) system, and—at a certain level of development—a central counterparty (CCP), liquidity support for repo transactions and introduction of DVP2 and DVP3 (intraday netting) all help to reduce risks. These functions may be seriously hindered when there are multiple CSDs, or when the CSD has limited functionality for multiple settlement methods.

75. **Sound governance and access policies of the FMI, as well as transparency of data and information increase the confidence of market participants.** Pre-trade and post-trade transparency should support and facilitate secondary market trading. The CSD should be able to collect and publish aggregated data with regards to transactions and holders of securities.

76. **In The Bahamas, systems for the registration, issuance, and settlement of government securities are operated by CBoB.** The CBoB maintains an electronic register of government securities in the newly launched BGSD, which interfaces with the country's Automated Clearing House (ACH) and RTGS payment and settlement networks. Order entry for bidding in government securities is now automated via an online portal maintained by the CBoB. Final payments and security transfers are protected by regulation. However, while the BGSD provides payment, settlement and registration facilities within one system, it is not subject to regulatory oversight by the Securities Industry Commission and there is no regulator overseeing its conduct.

77. **Currently, the BGSD uses gross settlement (DVP1) with T+2, but other settlement cycles (T+0 and T+1) could be used in the system.** Intraday netting DVP2 and DVP3 will be available once market development reaches a higher stage. No Central Counterparty (CCP) exists at present.

78. **The BGSD guidelines require the members to hold client assets separately from their own assets.** To protect trade execution, BGSD may maintain a Settlement Guarantee Fund ("SGF") to guarantee the settlement of trades executed on the BGSD, but it is not in operation as yet. BGSD may also establish and maintain an Investor Protection Fund ("IPF") for the protection of the clients interests in the event that clients suffer pecuniary losses arising from negligence of BGSD or by its members/participants while carrying out the instructions of the client.

79. **While the current BGSD system is in its infancy and is cautiously welcomed by market participants, the future efficacy of the market infrastructure may be negatively impacted by the existence of two CSD systems.** Institutions seeking to execute cross-market trades (e.g., selling corporate bonds to purchase government securities) might face delays and potential operational and settlement risk as the two systems are not connected electronically. Capital markets liquidity will be separated into different market segments. This fragmentation of market sectors is inimical to the development of liquid capital markets.

80. **Alongside a small number of corporate bonds, 240 government bonds are listed on the BISX.** Each security carries a unique securities identification code, similar to an ISIN but generated by the CBoB. Any trade conducted between two counterparts not involving the CBoB must be registered and "crossed" via the BISX. The BISX publishes general summaries of primary and secondary capital markets activity on a regular basis, but reporting on turnover among equities and debt instruments is comingled and no dedicated narrative is offered for the government securities market, even though the 240 BRS lines dominate the BISX in terms of the number of listed instruments.

81. **Currently, the BGSD does not charge custody or registry fees.** Market participants welcome this, as they appear averse to paying fees of any nature at any stage of the

investment process. However, the CBoB is contemplating the introduction of platform fees from 2024 onwards, to cover running costs on a cost-recovery basis.

82. **There is scope to provide information on aggregate transaction volumes, both over time and across different investor type classifications.** Currently, the CBoB provides no information on transaction flows and publishes general summaries of holdings by domestic investor class sporadically. The mission was encouraged to learn of the CBoB's interest to use more detailed information on primary and secondary investor turnover, both for further analysis and aggregate publication. Leveraging the securities registrar to increase awareness of the investor base for government securities is an important step for improving the credibility and integrity of the financial market infrastructure.

Recommendation

Phase 1 (6 to 12 months)

- Leverage the trade intelligence embedded within the CSD system to understand better investment activity and publish aggregate summaries of investor in a more accessible format.

- Finalize plans on investor protection, repo markets, and enable over-the-counter trading.

- Consider establishing a bridge between the BGSD and BCSD for efficient cross-market settlement.

Phase 2 (12 to 24 months)

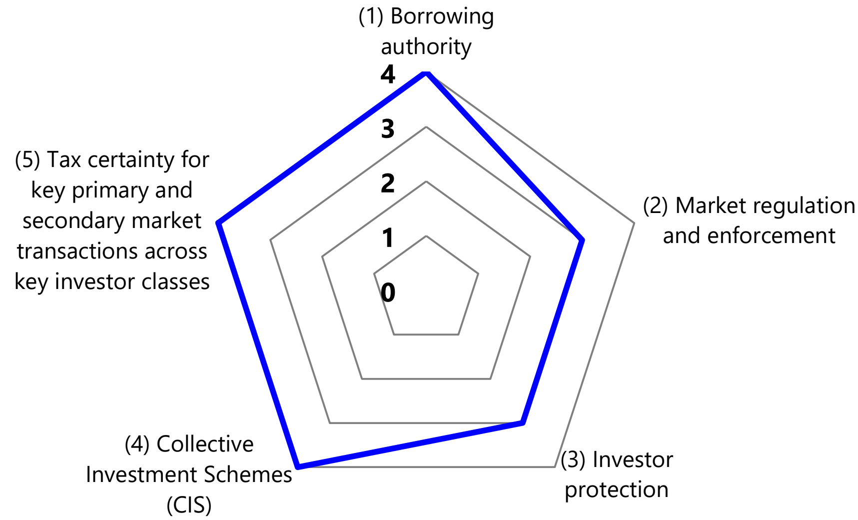
- Consider privatizing the BGSD to allow the private sector to take responsibility for a key component of the capital markets infrastructure.

G. Legal and Regulatory Framework

Assessment

83. **The legal and regulatory framework in The Bahamas is assessed at stage 3.8 ("mature").** The score reflects strength across all dimensions and attests to the strong legal and regulatory foundation in the countryas well as recent legislative reform (e.g. the new law on public debt management).

Building Block Figure 7. Legal and Regulatory Framework



Stage 1. Nasacent – Stage 2. Developing – Stage 3. Emerging – Stage 4. Mature

Sources: MoF, CBoB, and IMF staff calculations

84. **A robust legal and regulatory framework is a key precondition for the proper functioning of all other building blocks within the LCBM.** Strong legal and regulatory framework support fair, efficient, and transparent markets. The LCBM legal and regulatory diagnostics focus on five major aspects of the legal environment: (i) the borrowing authority; (ii) market regulation and enforcement; (iii) investor protection; (iv) collective investment schemes; and (v) the legal framework for taxation.

85. **The framework governing public debt and the government securities market in The Bahamas comprises various acts of legislation and regulations.** Key laws in related to public debt and government debt management activities are the Public Debt Management Act 2021 (PDMA), the Fiscal Responsibility Act 2018 (FRA), and the Central Bank of The Bahamas Act 2020 (CBoBA). Key laws with an impact on the government securities market include the Securities Industry Act 2011 (SIA), the Investment Funds Act 2019 (IFA), and the Financial Transactions Reporting Act 2018. In addition, the CBoB has prepared guidelines and business rules for the BGSD.

Authority to Borrow

86. **The PDMA contains provisions consistent with a modern public debt management law.** The act sets forth objectives for debt management (section 4). In addition to the standard objective of financing the government and meeting its payment obligations at lowest cost over the medium term, subject to a prudent degree of risk, it identifies promotion and efficient functioning of the local government securities market as an objective. The act confers the authority to borrow solely on the Minister of Finance (section 16), and that

authority may not be delegated (section 17). It defines the purposes for which borrowing may be undertaken (section 18) and allows for a range of operations for managing cash flows and portfolio risks (section 14), including repo transactions. Complementing the PDMA is the CBoBA, which designates the CBoB as fiscal agent for the government (section 20) and sets limits of the volume of credit that it may extend to the government through advances and holdings of securities (section 21).

87. **The PDMA also establishes the debt management office (DMO) within the MoF and defines its roles and responsibilities, alongside those of the Minister of Finance, the Financial Secretary, and other actors.** The DMO is responsible for both day-to-day and strategic management of the debt portfolio, encompassing front, middle, and back-office functions (section 7). Notably, the act requires the DMO to develop, implement, review, and publish a medium-term debt management strategy (MTDS) and an annual borrowing plan (ABP). The strategy should be approved by Cabinet (section 12). While the DMO develops its capacity to carry out debt management functions, many front and back-office activities are performed by the CBoB, under a memorandum of understanding. These include the preparation of prospectuses for government securities, the administration of auctions and tap sales, the recording and registration of government securities, and the payment of debt service. The PDMA provides for the CBoB to establish a central securities repository within the central bank or to facilitate the establishment of as an independent private entity outside the central bank (section 62).

88. **The MTDS and ABP that have been prepared to-date are an impressive achievement, but their content could be strengthened.** The MTDS is comprehensive, with, inter alia, an analysis of the composition and cost and risk characteristics of the debt portfolio, macroeconomic and market factors relevant to borrowing, and analysis of how the portfolio would evolve under different assumptions of the financing mix. However, the strategy document lacks clarity which reduces its value for informing investors, market participants, and other stakeholders. In particular, it is important to avoid confusion as to the actual strategy that has been approved and will be implemented.

Market Regulation and Enforcement

89. **The principal act for regulation and enforcement in the government securities market is the SIA.** Although the government as issuer is exempted from certain filing requirements (section 92), participants in the government securities market and trading involving government securities fall under the act. Provisions in the SIA prohibit market manipulation (section 109), false trading and market-rigging (sections 110 and 111), dissemination of false or misleading information (section 115), front-running (section 120), and other forms of misconduct. Short-selling is permitted insofar as the act is silent. A new version of the SIA is in preparation and is expected to sent to parliament in late 2023. The new law will explicitly address short-selling and modernize numerous other provisions.

90. **The Securities Commission is the main body responsible for market regulation and enforcement, although the CBoB plays an important role in the government securities market.** They share information on a monthly basis on the entities that they jointly license. There are quarterly meetings of the entire group of financial services regulators. The SIA empowers the Securities Commission to investigate (Section 42), obtain information (section 43), inspect (section 45), require reports (section 46), receive financial statements and auditor reports of registered firms (section 77), and more generally monitor market participants and activity. In addition, the SIA authorizes the Securities Commission to issue compliance orders (section 132), take legal action (section 134), impose administrative penalties (section 135), remove benefits (section 136), and recover costs (section 137). According to the Securities Commission, it not only has the authority granted to it in law, but also has the capacity to monitor the market and enforce market conduct rules. Market participants confirm that assessment.

Investor Protection

91. **The CBoB has published guidelines and business rules for the BGSD.** The BGSD was launched in January 2023. Members are required to maintain separate accounts for each individual client and for own account, maintain separate records, and deliver periodic reports to clients and to the CboB. The CboB monitors and is able to enforce compliance with the guidelines and rules, including those to safeguard investor ownership rights. The BGSD may establish an investor protection fund to compensate clients who suffer losses due to the negligence of the BGSD itself or of BGSD intermediaries. At the time of the mission, the fund had not been set up.

92. **Similar protections exist for the BCSD operated by BISX.** BISX does not operate an investor compensation fund or a settlement guarantee fund. The former would compensate investors for loss suffered as a result of non-fulfillment of contractual obligations by broker-dealers. The latter would support timely and seamless settlement of the securities trades.

93. **The BGSD guidelines and rules provide for repo transactions and third-party rights/encumbrances in respect of government securities.** Given the absence of repo transactions, market participants have not yet adopted the Global Master Repurchase Agreement (GMRA) standard contract.

Collective Investment Schemes

94. **The principal act for regulation of collective investment schemes (CISs) is the IFA, and the Securities Commission is responsible for administering and enforcing the act.** Under the IFA, the Securities Commission regulates the licensing and operation of investment funds and investment fund managers. Provisions in the law require extensive disclosure and reporting to investors and to the Securities Commission, including quarterly mark-to-market valuation of holdings.

95. **CISs may play an important role in mobilizing household savings in the domestic capital market and spreading financial literacy among the population.** Some financial institutions in The Bahamas already offer CISs, but there is room for expansion. The government is intended to introduce retail savings bonds in addition to the non-competitive bidding carve-out for retail investors in auctions. Retail savings bond programs, however, are typically administratively costly and are seldom a reliable and stable source of financing. Depending on their design, they may also complicate cash flow management. A preferable option would be to encourage the development of a government securities mutual fund. This fund would allow retail investors to obtain exposure to government securities in their investment portfolios.

Legal Framework for Taxation

96. **The legal framework for taxation does not introduce distortions to the government securities market that would impede its further development.** As The Bahamas has no personal or corporate income tax, including on the returns from government securities, there is tax certainty and neutrality for both primary and secondary market transactions across major investor classes.

Recommendations

Phase 1 (6 to 12 months)

- Continue to refine the content and format of the MTDS and the ABP to improve their usefulness for investors and market intermediaries.
- Introduce repo transactions as one of the key revisions to the SIA.
- Provide more information in the ABP, including volumes of individual benchmark issues.
- Strengthen the commitment to adhere to the pubished MTDS and the ABP.

Phase 2 (12 to 24 months)

- Strengthen the legal framework for financial collateral, with a carve-out in the event of insolvency of a market participant.
- Sponsor the adoption of the GMRA standard contract to facilitate repo market development.
- Introduce close-out netting to ensure that the rights of the repo partners can be enforced in court, in case one of the parties defaults.
- Modernize the legal framework for bankruptcies and financial collateral, which is currently fragmented across multiple laws.

III. Conclusion and Policy Sequencing

97. **The Bahamas' overall macroeconomic framework is strong and conducive to further developing its domestic government securities market.** With debt being assessed as sustainable, improving economic conditions, a diversified investor base, the existence of a yield curve and benchmark securities, and a sizeable NBFI sector, The Bahamas meets many of the preconditions for further developing the local domestic bond market.

98. **Better coordination between the CBoB and MoF will be essential to advance reforms and develop the local bond markets.** The different and interconnected responsibilities of many agencies, (the CBoB, MoF, BISX, and Securities commission), and the weak coordination across them is hindering market development. Improved coordination and a clearer delineation of the roles and responsibilities of each stakeholder would also facilitate capacity buildup in the MoF, which will be essential as it undertakes additional tasks.

99. **Table 1 lists the main recommendations as well as the timeline for these reforms.** Initial efforts should focus on improving the primary market. Only after once true improvments have occurred second- and third-phase recommendations should be undertaken. Secondary market reforms should await until there is a vibrant, functioning, price-taking primary market.

100. **Improvements in investor relations and debt reporting would greatly facilitate market functioning.** Uncertainty regarding bond auctions, improvement of data and transparency in the MTDS and ABP, and more systematic outreach to creditors are areas where quick progress can be made. Improvements in debt reporting by updating the MTDS/ABP and strengthening the investor relations function would directly improve market functioning. Follow-up Fund TA, by IMF/CARTAC, would play a useful supporting role in accelerating reforms in key areas during the initial phases.

101. **Annex II provides a suggested draft structured TA delivery framework for the IMF/CARTAC to support the authorities.** The Annex prioritizes the most immediate needs, including primary market reforms, becoming a price-taker in auctions, investor relations, and improving coordination between cash and debt management.

102. **Progress should be monitored by a designated official who has the authority to lead and promote the reform process across various agencies.** The LCBM framework allows for an evaluation of progress on each area relevant to the domestic debt market. Improvements in local currency bond markets could be reported annually as part of an MTDS to monitor progress and maintain high-level support.