

**Barbados: Financial System Stability Assessment,
including Reports on the Observance of Standards and Codes on
the following topics: Monetary and Financial Policy Transparency,
Banking Supervision, Securities Regulation, Insurance Regulation,
Corporate Governance, and Payment Systems**

This Financial System Stability Assessment on **Barbados** was prepared by a staff team of the International Monetary Fund and the World Bank as background documentation for the periodic consultation with the member country. It is based on the information available at the time it was completed on **January 17, 2003**. The views expressed in this document are those of the staff team and do not necessarily reflect the views of the government of **Barbados** or the Executive Board of the IMF.

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BARBADOS

Financial System Stability Assessment

Prepared by the Monetary and Exchange Affairs and Western Hemisphere Departments

Approved by Stefan Ingves and Anoop Singh

January 17, 2003

- This report is part of the joint Bank-Fund Financial Sector Assessment Program (FSAP) aimed at assessing vulnerabilities of financial systems, their development needs, and the implementation of relevant financial sector standards. The report is based on a mission that visited Barbados during June 24 to July 12, 2002 and was discussed with the authorities during the 2002 Article IV consultation mission in October.¹
- The FSAP team met with Dr. Marion Williams, Governor, Central Bank of Barbados (CBB); Mr. Grantley Smith, Director of Finance and Economic Affairs, Ministry of Finance; Sir Neville Nicholls, Chairman, Securities Commission; Mrs. Virginia Mapp, General Manager, Barbados Stock Exchange; Mr. Carlos A. Holder, Deputy Governor, CBB; Mr. Darcy Boyce, Deputy Governor, CBB; Mr. Harold Codrington, Adviser to the Governor, CBB; other staff of the CBB; Ms. Lynette Eastmond, Director of International Business, Ministry of Economic Development; Mr. Carlos Belgrave, Supervisor of Insurance, Ministry of Finance; Mr. Murray, Registrar of Cooperatives; Mr. Guyson Mayers, Financial Intelligence Unit; and representatives of commercial banks, external auditing firms, and other private sector institutions.
- Systemic risks in the financial sector are generally contained, although the sector faces considerable challenges. Repercussions of the recent economic recession on the banking system are being felt, and profitability and asset quality are likely to be depressed in the near-term. Aggregate financial soundness indicators suggest that the system can withstand these pressures without major difficulties. Compliance with international supervisory standards is generally high, especially in the onshore and offshore banking sectors, but considerable weaknesses are evident in the insurance area. Over the medium-term, financial integration under the Caribbean Single Market and Economy (CSME) framework will necessitate adaptations in domestic policies, prudential regulations, and monetary policy instruments.
- Mission members wish to express their deep appreciation to the Barbados authorities and staff of all the public and private sector institutions that they visited for their kind hospitality and cooperation in sharing information and insights.

¹The FSAP team was led by Messrs. S. Kal Wajid (IMF, Mission Chief) and Giovanni Majnoni (World Bank, Deputy Mission Chief) and was composed of Messrs. Robert Keppler, John McDowell, Craig Thorburn, Mss. Bikki Randhawa, Melinda A. Roth (all World Bank); Messrs. Tonny Lybek (MAE), Vassili Prokopenko (MAE), Mss. Ruby Randall (WHD), Massa Lansanah-Richardson (Admin. Assistant-MED) (all IMF); and Messrs. Carlisle Procter (external expert, formerly with the Reserve Bank of Australia), Keith Bell (external expert, formerly with the Office of Superintendent of Financial Institutions, Canada), and Erik Huitfeldt (external legal expert).

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ACRONYMS

| | |
|---------|--|
| ACH | Automated Clearing System |
| AML/CFT | Anti-Money Laundering and Combating Financing of Terrorism |
| BCCI | Bank of Credit and Commerce International |
| SDI | Barbados Central Securities Depository Inc |
| BNB | Barbados National Bank |
| BSE | Barbados Stock Exchange |
| BSD | Banking Supervision Department |
| CARICOM | Caribbean Community and Common Market |
| CARTAC | Caribbean Regional Technical Assistance Center |
| CBB | Central Bank of Barbados |
| CBRTGS | Central Bank of Barbados RTGS System |
| CIBC | Canadian Imperial Bank of Commerce |
| CSME | Caribbean Single Market and Economy |
| FCIB | First Caribbean International Bank |
| FIA | Financial Institutions Act |
| FIU | Financial Intelligence Unit |
| IAIS | International Association of Insurance Supervisors |
| NPSC | National Payments System Council |
| OECS | Organization of Eastern Caribbean States |
| PEARLS | Protection, Effective financial structure, Asset quality, Rates of return and costs, Liquidity and Signs of growth |
| RTGS | Real Time Gross Settlement System |
| SC | Securities Commission |

SECTION I. STAFF REPORT ON FINANCIAL SECTOR ISSUES

I. OVERALL STABILITY ASSESSMENT

1. ***Systemic risks in the financial sector are generally contained, although the sector faces considerable challenges both in the short- and medium-term.*** Repercussions of the current economic slump, caused by the downturn in tourism, on the banking system are being felt, and profitability and asset quality are likely to be depressed in the near-term. Aggregate financial soundness indicators, however, suggest that the system can withstand a moderate recession without major difficulties. Over the medium-term, financial integration under the Caribbean Single Market and Economy (CSME) framework will necessitate adaptations in domestic policies, prudential regulations, and monetary policy instruments, and the authorities would be well advised to prepare in advance.
2. ***Indicators of the health of the banking system and sensitivity analysis suggest that the system is resilient and fundamentally sound.*** However, given that financial soundness indicators tend to lag current performance, the tentative nature of the sensitivity analysis, and the uncertainty surrounding the underlying assumptions, developments in asset quality and the adequacy of provisioning warrant close monitoring. Capital adequacy for the four locally incorporated banks is relatively high (18.2 percent of risk weighted assets) and all commercial banks reported profits in 2001. Although nonperforming loans (NPLs) increased in 2001, they accounted for 5 percent of total loans, with about half fully provisioned.
3. ***Stress tests indicate that credit risk is the primary source of vulnerability, but it would take a 90 percent increase in NPLs and full provisioning, for the system to breach the statutory capital adequacy requirement.*** While this may seem comforting, considering the rise in NPLs in 2001, or that seen in other countries in the context of a prolonged period of negative growth, the downside risks may be less benign than suggested by the analysis. For the least capitalized bank this quantum of increase in NPLs could create insolvency problems.
4. ***Off-shore banks are, to a large extent, insulated from the domestic banking system and their deposit taking activities are highly circumscribed, thereby limiting their potential to destabilize the domestic financial system.*** However, the importance of wealth management and treasury services in their operations exposes them to considerable market and transfer risks. While the dominance of equity and parent/owner deposits in their liability structure also provides them with the capacity to cope with these risks, because of the potential reputational consequences for Barbados, should these risks materialize, it seems important to explicitly provide for market risks in the capital requirements of offshore banks. The importance of soon introducing measures to better monitor market risks is also underscored by the merger of the Caribbean operations of Barclays PLC and Canadian Imperial Bank of Commerce (CIBC) to form First Caribbean International Bank (FCIB) with operations in jurisdictions with floating exchange rates and no capital account restrictions.

5. ***Considering the presence of exchange controls and the structure of banks' portfolios, interest rate and operational risks do not, at this time, appear significant.***

Nevertheless, the gradual liberalization of the controls that has been initiated, the formation of the FCIB, headquartered in Barbados, the large portfolio of government debt held by banks, and the potential for contagion from turmoil in major Latin American countries underscore the importance of measures to better address these risks.

6. ***Compliance with the international supervisory standards is high both in the onshore and offshore banking sector which helps limit systemic vulnerability.*** Supervisory compliance in the offshore banking sector has been facilitated by the recent passage of the International Financial Services Act. The mission's assessment of compliance with the Basel Core Principles for Effective Bank Supervision for the onshore banks and financial institutions indicates that of the 30 principles, 24 are "compliant" or "largely compliant," 4 are "materially noncompliant" and 2 are "not compliant." Areas with less than full compliance concern: the need to boost supervisorial resources, legislative changes to enhance the independence of the Central Bank of Barbados (CBB), information sharing with other supervisory agencies, measures against market risks, and consolidated supervision. Addressing these should result in greater resiliency of the financial system.

7. ***The rapid expansion of the credit union sector, with assets equivalent to 10 percent of GDP, has been associated with a weakening in the quality of their lending portfolio.***

One fifth of outstanding loans are classified as delinquent and their recovery may be affected by their concentration among lower income borrowers. Supervision of the largest five credit unions, accounting for over 80 percent of total assets of the sector, has been recently strengthened by intensified collaboration between the Registrar of Cooperatives and the CBB. Evidence from the recently initiated joint inspection program may necessitate amendment of the law to support a tightening of the regulatory and supervisory framework, including the authority to impose sanctions.

8. ***Settlement risk has been greatly reduced with the institution of the real time gross settlement system (RTGS) and the automated clearing system (ACH).*** The authorities deserve credit for undertaking the modernization of the payment systems, although a more complete assessment has not been possible pending experience with the full operation of RTGS system. The RTGS system is systemically important and has been designed to be in accordance with the CPSS Core Principles. The ACH is judged not to be systemically important.

9. ***The insurance sector is quite dynamic and has experienced good profitability and expanded operations in other countries in the region, but there are serious weaknesses in the regulatory and supervisory framework.*** Limited diversification opportunities in the saturated domestic market has induced insurance companies to seek business abroad, underscoring the need for vigilant supervision. The supervisory weaknesses are reflected in less than full observance of many of the Core Principles for Effective Supervision established by the International Association of Insurance Supervisors (IAIS). The assessment indicates that out of 17 principles, 10 for the domestic sector and 12 for the offshore sector are

“observed” or “largely observed.” Areas of non-observance concern the organization and resources of the supervisor, implementation of prudential rules and onsite inspections.

10. ***Capital markets remain underdeveloped and appear to present little systemic risk, given the low level of activity in the market.*** Limited activity and market size underscore the need to consider the development of the stock market in a regional context. This could result in opportunities for diversification and reduction of fixed costs, but would require the adoption of common listing, trading, and settlement rules. In addition, it would warrant further relaxation of restrictions on investments on the stock exchanges within the region. The mission assessed the observance of the IOSCO Objectives and Principles and found that most of the principles are either “implemented” or “partially implemented” and only two are considered “not implemented.” Areas where implementation is not in line with international standards concern effective inspections and prudential and regulatory requirements. The assessment takes into account the progress made in strengthening securities regulations through the newly created but not as yet fully staffed Securities Commission.

11. ***Preparations for capital account liberalization should involve prudent macroeconomic policies and other well sequenced measures to foster efficient markets and strengthen supervision and regulation.*** It would be important, in particular, to ensure the adequacy of prudential regulations regarding foreign exchange exposures and market risks in order to limit the risk of instability from cross-border capital flows. In addition, the monetary policy framework and instruments will need to be more flexible and market oriented in order to facilitate both market development and monetary control.

12. ***The mission also found a high degree of observance of the IMF’s Code of Good Practices on Transparency in Monetary and Financial Policies.*** Transparency practices in accordance with the Code, however, are so far less prevalent in the securities area, but are likely to be largely observed once the Securities Commission becomes fully operational. In the insurance sector, there is a need to substantially enhance transparency practices. Accounting, auditing, and disclosure practices appear broadly in line with the international standards.

13. ***The authorities have worked hard to develop an effective framework for anti-money laundering and combating financing of terrorism (AML/CFT).*** The Anti-Money Laundering Authority is well organized and carries out its mandate through the Financial Intelligence Unit (FIU). The limited staff and resources of the FIU, however, necessitate heavy reliance on the supervisory bodies responsible for the oversight of various financial institutions. As a result, the degree of AML/CFT effectiveness is commensurate with that of the broader supervision of such institutions. In particular, effectiveness needs most attention in the insurance area and, to a lesser extent, given the limited activity, in the securities market.

14. ***The mission made a number of recommendations detailed in the main FSAP report, including:***

- Boosting the supervisory resources of the CBB to enable it to conduct regular onsite examinations of all onshore and offshore banks on an 18–24 months cycle; adopting regulations to provide for market and country risks for both onshore and offshore banks; and amending the Financial Institutions Act to strengthen the independence of CBB, impose aggregate limits on large exposure and connected lending, facilitate license revocation and distressed bank resolution, and require CBB’s prior approval of the external auditor for licensees.
- Completing the CBB assisted on site examinations of the five large credit unions and making such examinations regular. Consideration could be given to introducing a separate credit unions law in light of the experience gained with these examinations. In the meantime, the capacity of the Registrar of Cooperatives to effectively supervise credit unions should be strengthened.
- Instituting effective supervision and regulation of the insurance sector, including by increasing supervisory resources, independence and transparency, and by developing financial soundness standards and issuing related circulars.
- Developing a framework for using market-based instruments of liquidity management and allowing greater market determination of interest rates.

II. MACROECONOMIC SETTING AND RISKS

A. Recent Developments and Vulnerabilities

15. ***The global economic slowdown poses near-term macroeconomic challenges for Barbados.***² Following a prolonged period of robust growth, real GDP contracted 2.7 percent in 2001. The slump continued during the first half of 2002, reflecting the effects on the tourism industry of the global downturn and the September 11 terrorist attack. While aggregate financial soundness indicators suggest that the banking system can cope with the consequences of the slowdown, profitability of the sector is likely being squeezed and erosion in asset quality can be expected. Difficulties at individual institutions cannot be ruled out, although banks are making the required provisions for bad debts.

16. ***The banking system experienced high levels of excess liquidity during much of 2001 and 2002 in the context of low inflation, but lending rates did not respond commensurately.*** Concerns about collusive behavior among banks prompted the central bank

²Macroeconomic developments and risks are discussed in detail the staff report for the 2002 Article IV consultation (SM/02/383).

to initially introduce an indicative average lending rate in July 2001 on credit to the productive sectors, which was subsequently made compulsory and reduced from 10 percent in August 2001 to its current level of 8.0 percent. The policy has not stimulated lending, since banks are of the view that the rate does not adequately compensate them for the riskiness of loans, notwithstanding the availability of a credit insurance facility. In principle, cross-border banking services could promote more competition. This should proceed in the context of the authorities' plan to liberalize capital account transactions with the CARICOM (Protocol No. 2).

17. ***Prospects for the development and deepening of the financial system over the medium-term are linked importantly to the liberalization and integration of financial activities envisaged under the Caribbean Single Market and Economy (CSME) protocols.*** The authorities plan to gradually liberalize exchange controls, first vis-à-vis the Organization of Eastern Caribbean States (OECS), and then more broadly among the CARICOM countries. The strategic considerations underpinning this initiative are compelling and will likely yield substantial efficiency gains and diversification opportunities in the financial sector. At the same time, the different degrees of exchange controls, types of exchange rate arrangements, and monetary policy and prudential frameworks within CARICOM and vis-à-vis the rest of the world, necessitate careful preparation.

18. ***Preparations for capital account liberalization entail adaptations in domestic policies, regulations, and instruments.*** Prudent macroeconomic policies, especially restraint on wage increases and the fiscal deficit are important for preserving external competitiveness and the credibility of the exchange rate regime. Strengthened supervision and regulation, particularly regarding foreign exchange exposures and market risks, will be crucial in limiting the potential for financial instability from cross-border capital flows. A properly coordinated and sequenced liberalization will also necessitate a careful evaluation of the capacity of financial institutions to assess and manage risks associated with cross-border exposures and of the supervisory processes to contain their effects should the risks materialize.

19. ***The outlook for Barbados' offshore financial sector is subject to some uncertainty.*** Activities in this sector have been attracted by low tax rates and the advantageous provisions of bilateral tax treaties with some countries. Doubts about the renewal of these treaties—with Canada (presently being renegotiated), the U.S., the U.K., and Switzerland—as well as competition from other countries offering similar advantages are beginning to deter new entrants. Meanwhile, the authorities have taken several measures to strengthen the regulation and supervision of the onshore and offshore financial sector, with a view to preserving and enhancing the reputation of Barbados as a financial center.

B. Systemic Liquidity Management

20. ***Under the current circumstances there is little risk of a systemic liquidity crisis.*** The substantial excess liquidity, however, is symptomatic of an over-determined system, with a mandatory minimum savings deposit rate, a maximum average lending rate, and a pegged

exchange rate regime supported by exchange controls. The efforts to administer lower domestic interest rates prevent lending rates from properly reflecting risk-return tradeoffs and cause banks to be overly cautious in extending credit.

21. ***The fixed exchange rate regime and exchange controls allow the CBB to give less priority to active day-to-day liquidity management and monetary policy is largely conducted through adjustment in administered interest rates.***³ Excess liquidity mounted sharply in 2002, reflecting the persistent weak demand for credit following the widespread economic slowdown. In early June 2002, total bank reserves stood at almost three times the required reserves, while banks' holdings of government securities were 30 percent higher than the prescribed minimum. As a result, the excess liquidity ratio (the ratio of the sum of excess reserves and excess government securities holdings to the deposit base) increased to more than 17 percent from 8 percent at the end of 2000 (Table 1), and treasury bill rates declined to historically low levels.⁴

22. ***There do not appear to be major legal or institutional impediments in the interbank market, but substantial excess liquidity at most banks has tended to drive down activity.*** The CBB estimates that commercial banks currently conclude "at best" only 2 to 3 transactions per week.⁵ While the excess liquidity ratio varies from bank to bank, there are no clear signs of market segmentation. Banks do, however, maintain counter-party limits on interbank exposures, and transactions in the market are typically overnight and unsecured.

23. ***The CBB's tools for liquidity management include both direct and indirect instruments, although more flexible market-based instruments will be needed as exchange controls are liberalized.*** At present, the main instruments are changes in cash reserve and securities requirements, regular tender sales of government securities, and adjustments in official interest rates. The CBB does not conduct active open market operations and currently has only a small amount of government securities in its portfolio. It also maintains a discount facility which has not been used by banks for some time because of excess liquidity. The CBB could consider developing a framework for using market-based instruments for influencing monetary conditions in order to minimize distortionary costs on the banking system. Such a framework will be needed in an environment of liberalized capital flows and would require that rates of return on government securities are determined by the supply and demand of funds in a transparent auction process.

24. ***Consideration could also be given to a gradual deregulation of interest rates to support the liberalization of exchange controls.*** The present policy of stipulating a minimum savings rate introduces downward rigidity in interest rates. At the same time, the

³The Barbadian dollar has been pegged to the U.S. dollar since mid-1975 at BDS\$2.00=US\$1.00.

⁴Three-months treasury bill rates stood at around 2.5 percent at the end of second quarter 2002.

⁵The CBB does not collect the information on the performance of interbank money market.

average lending rate is an attempt to induce commercial banks to reduce their intermediation spreads, but could in effect restrain banks' lending and create an incentive for circumvention and compensation through increased level of fees and other charges. A preliminary decomposition of spread between lending and deposit rates indicates that the high spread likely inhibited financial intermediation and its widening in recent years may reflect banks' rising costs and possibly the oligopolistic structure of the banking industry. Policies to foster greater competition for loans under a liberalized regime of capital flows could contribute to reducing the spreads and thereby increase financial intermediation.⁶

Table 1. Liquidity Indicators of the Banking System
(In BDS\$ million; unless otherwise indicated)

| | 2000 Dec. | 2001 Mar. | 2001 Jun. | 2001 Sep. | 2001 Dec. | 2002 Mar. | 2002 ¹ Jun. |
|---------------------------------------|--------------|--------------|--------------|--------------|--------------|--------------|---------------------------|
| Reserves | 245.6 | 293.7 | 349.6 | 349.1 | 307.2 | 426.1 | 597.8 |
| Required Reserves | 220.4 | 225.9 | 228.0 | 193.7 | 196.3 | 201.6 | 209.0 |
| Excess Reserves | 25.2 | 67.8 | 121.6 | 155.4 | 110.9 | 224.5 | 388.8 |
| Government Securities | 969.8 | 973.6 | 977.8 | 1,034.4 | 1,050.4 | 1,091.4 | 1,083.8 |
| Required Holdings | 700.9 | 708.5 | 721.7 | 742.9 | 743.6 | 739.6 | 751.2 |
| Excess Holdings | 268.9 | 265.1 | 256.1 | 291.5 | 306.8 | 351.8 | 332.6 |
| <i>Memorandum items (in percent):</i> | | | | | | | |
| Cash Reserve Requirement | 6.0 | 6.0 | 6.0 | 5.0 | 5.0 | 5.0 | 5.0 |
| Securities Requirement | 19.0 | 19.0 | 19.0 | 19.0 | 19.0 | 18.0 | 18.0 |
| Excess Liquidity Ratio ² | 8.0 | 8.9 | 9.9 | 11.4 | 10.7 | 14.0 | 17.3 |

Source: CBB.

¹ As of June 12, 2002.

² Excess liquidity ratio is the ratio of the sum of excess reserves and excess government securities holdings to the deposit base.

III. OVERVIEW OF THE FINANCIAL SYSTEM AND REGULATORY STRUCTURE

25. *Given the small size of the economy, the financial system in Barbados is quite sophisticated, although it remains dominated by banks.* As in many other economies in the region, the system comprises both onshore and offshore activities. The onshore sector provides financial services for residents and has enjoyed stability and confidence in recent years. The offshore sector caters mostly to nonresidents outside the CARICOM area and has become an important contributor to economic activity. To preserve the perception of

⁶An analysis of intermediation spreads is contained in the Selected Issues Volume of the FSAP report.

Barbados as a reputable financial center, the authorities have continued to adapt, modernize, and strengthen the supervision of the financial services industry.

A. The Onshore Financial Sector

26. ***The onshore financial sector is well developed and encompasses a wide range of financial institutions.*** There are 7 commercial banks, 14 nonbank financial institutions, 41 credit unions, 9 life insurance, and 10 general insurance companies (Table 2). At end-2001, assets of commercial banks accounted for 105 percent of GDP and about 81 percent of the assets of all deposit-taking institutions. In addition, commercial banks accounted for 82 percent of all deposits, around 74 percent of loans and advances.

27. ***The commercial banking system is largely foreign owned.*** About 74 percent of the assets of commercial banks belong to either branches of foreign banks or subsidiaries of foreign-owned entities from Canada, United Kingdom, and Trinidad and Tobago. Some of the Caribbean activities of Barclays PLC and CIBC have been merged with the formation of FCIB, headquartered in Barbados, with operations in 15 countries and 8 jurisdictions. The bank is subject to supervision by the CBB which is the home country supervisor. The merger has resulted in further concentration in the banking system, with FCIB accounting for about 33 percent of total assets and Royal Bank of Canada, the second largest, for about 19 percent. The government continues to own a large share of Barbados National Bank (BNB). Following a loan workout arrangement for the sugar industry, the BNB was recapitalized in 1996 and has since remained profitable. The government expects to further reduce its ownership in the bank.

28. ***There are a number of other financial institutions—part III companies—comprising trust companies, finance companies, and merchant banks.*** They are not allowed to accept demand deposits, offer checking accounts, or have access to the Central Bank of Barbados' discount facility. At the same time, they are not subject to required reserves and have a lower minimum capital requirement. The charter of each licensed part III institution specifies its activities. At end-2001, total assets of such institutions amounted to about 19 percent of GDP.

29. ***Credit unions have expanded rapidly in recent years and are competing with banks in the consumer lending segment.*** They are restricted from accepting demand deposits, issuing checkbooks and accepting deposits or making loans denominated in foreign currency. As of end-2001, there were 41 credit unions with 94,728 members—more than a third of the total population—with total assets equivalent to 9½ percent of GDP. The largest credit unions are almost as large as the smallest bank. Credit unions are allowed to accept deposits of nonmembers but are prohibited from lending to them.

Table 2. Structure of Deposit-Taking Institutions, ^{1/} 1999–2001

| Financial institutions | Number of institutions/owner | Assets | | | Deposits | | | Loans | | |
|---------------------------------------|---|------------------|-------|-------|----------|------|-------|-------|------|------|
| | | 1999 | 2000 | 2001 | 1999 | 2000 | 2001 | 1999 | 2000 | 2001 |
| | | (percent of GDP) | | | | | | | | |
| Commercial banks^{2/} | 7 | 95.4 | 94.4 | 104.7 | 78.7 | 78.6 | 85.0 | 52.6 | 52.2 | 52.8 |
| <i>Of which:</i> | | | | | | | | | | |
| Foreign-owned ^{2/} | 5 | 73.2 | 74.0 | 77.6 | 61.8 | 60.8 | 65.0 | 40.5 | 39.7 | 39.9 |
| Barclays Bank PLC | Branch of foreign bank ^{3/} | 18.5 | 20.3 | 19.4 | 17.0 | 17.7 | 17.8 | 11.2 | 10.9 | 9.5 |
| Royal Bank of Canada | Branch of foreign bank | 19.6 | 17.2 | 19.9 | 18.1 | 15.7 | 18.3 | 6.9 | 6.6 | 7.1 |
| Bank of Nova Scotia | Branch of a Canadian bank | 15.7 | 17.0 | 18.0 | 10.8 | 11.5 | 12.4 | 11.3 | 12.0 | 12.7 |
| CIBC Commercial Bank | Subsidiary of Canadian bank ^{3/} | 15.3 | 15.0 | 14.8 | 12.7 | 12.5 | 12.2 | 8.7 | 7.7 | 7.6 |
| Caribbean Commercial Bank | Owned by Trinidad based parent | 4.1 | 4.5 | 5.5 | 3.2 | 3.4 | 4.2 | 2.4 | 2.5 | 3.0 |
| Domestically owned ^{2/} | 2 | 20.2 | 22.2 | 24.9 | 16.4 | 18.1 | 20.4 | 10.3 | 10.6 | 11.8 |
| Barbados National Bank | Majority state-owned ^{4/} | 16.2 | 18.2 | 20.4 | 13.1 | 14.8 | 16.7 | 7.8 | 8.3 | 9.5 |
| The Mutual Bank of T'Ca. Inc. | Domestically owned | 3.9 | 4.0 | 4.5 | 3.3 | 3.3 | 3.7 | 2.5 | 2.3 | 2.3 |
| Nonbank financial institutions | 14 ^{5/} | | | | | | | | | |
| <i>Of which:</i> | | | | | | | | | | |
| Trust and mortgage companies | 6 ^{6/} | 8.5 | 9.8 | 9.7 | 5.7 | 6.2 | 6.7 | 7.6 | 8.1 | 8.6 |
| Finance companies and merchant banks | 7 ^{7/} | 3.4 | 4.1 | 5.4 | 2.7 | 3.4 | 4.6 | 2.5 | 2.8 | 3.3 |
| Credit unions | 41 | 7.5 | 8.2 | 9.5 | 6.0 | 6.6 | 7.9 | 5.3 | 5.8 | 6.8 |
| Total | | 114.7 | 116.5 | 129.4 | 93.0 | 94.9 | 104.1 | 68.1 | 68.9 | 71.5 |

Sources: Central Bank of Barbados; and published annual financial statements of commercial banks.

1/ Previously, so-called commercial houses, due to tradition, were also allowed to accept deposits from the general public, but this is now prohibited. Commercial houses can, however, issue commercial paper. In addition to deposit-taking institutions, Barbados Mortgage Finance Company, which is owned by Barbados National Bank and has total assets of about 3.0 percent of GDP at end-2001, and insurance companies can also lend to residents. Several quasi-fiscal funds (including Credit Guarantee Scheme for Small Businesses, Export Credit Insurance Scheme, Export Finance Guarantee Scheme, Export Rediscount Facility, Industrial Credit Fund, and Barbados Investment Fund), which are managed by the Central Bank of Barbados, can provide financing for specified purposes.

2/ The financial year of some institutions ends October 31. Thus, aggregated figures do not fully reveal the exact sum of figures.

3/ Barclays PLC and CIBC announced in July 2001 a plan to merge their activities in the Caribbean.

4/ Privatization of the Barbados National Bank was initiated in December 2000, but not all shares floated were sold. The state thus remains the majority shareholder.

5/ Nonbank financial institutions licensed under the Financial Institutions Act include trust-, finance-, and mortgage companies (including Barbados Mortgage Finance Company, which does not accept deposits), as well as merchant banks. One company is newly licensed and one does primarily business with nonresidents.

6/ Published information includes five companies.

7/ Published information includes three companies.

30. ***Insurance companies account for the bulk of nonbank onshore financial activities and offer a broad range of insurance products.*** The industry is in the process consolidation, with the takeover of the Life of Barbados by The Barbados Mutual Life Assurance Society. The merged company will be the largest, accounting for local market share of about 65 percent. Privatization of the state-owned Insurance Corporation of Barbados was initiated in late 2000, but the government remains its largest shareholder. Up-to-date aggregate statistics on the industry are not available. At end-1999, total domestic business-related assets of onshore insurance companies were 17.5 percent of GDP.

31. ***The size of the economy, concentration of ownership and modest development of the mutual fund industry have likely limited the depth and diversity of financial markets.*** The Barbados Stock Exchange (BSE) was inaugurated in 1987 and currently has 25 listed securities. The mutual funds industry includes 9 open-end funds and one closed-end fund. The lack of diversification opportunities and the modest liquidity associated with concentrated ownership has limited the role of the Stock Exchange. The level of market activity and liquidity is one of the lowest in the Caribbean region. There are a few private pension funds, and new draft legislation governing these funds is currently being discussed.

B. The Offshore Financial Sector

32. ***The offshore financial sector—or the international financial services industry—is legally separated from the onshore sector.*** Activities between onshore and offshore banks, for instance, require special permission by the Minister of Finance. The offshore sector comprises international business companies, foreign sales corporations, exempt insurance companies, societies with restricted liability, and offshore banks (Table 3). Lower taxation and tax treaties with several countries, including the United States and Canada, along with fewer regulatory restrictions, have been a key factor in the growth of offshore financial activities. The offshore sector is now second only to tourism in terms of foreign exchange earnings and an important contributor to tax revenue.⁷ In 2001, the largest increase in the number of entities was in “societies with restricted liabilities” and offshore banks.

⁷Precise figures on the importance of the offshore sector are not available. There are a number of derivative effects, largely from payment of wages, taxes, and purchases of local goods and services. It has been estimated that the offshore sector contributes to the employment of more than 3,000 persons and generates around US\$110 million annually in foreign exchange inflows (See Michelle Doyle and Anthony Johnson: “Does Offshore Business Mean Onshore Economic Gains,” Working Paper of the Central Bank of Barbados, 1999). It is estimated that offshore activities contribute almost 40 percent of the government’s corporate tax revenue, with international business companies as the main contributors.

Table 3. Number of Active Offshore Entities,^{1/} 1994–2001

| | 1994 | 1995 | 1996 | 1997 | 1998 | 1999 | 2000 | 2001 |
|--|-------|-------|-------|-------|-------|-------|-------|-------|
| International business companies ^{2/} | 1,474 | 1,822 | 2,126 | 2,632 | 3,073 | 3,399 | 3,855 | 4,065 |
| Foreign sales corporations ^{2/} | 1,172 | 1,514 | 1,726 | 2,291 | 2,608 | 2,857 | 2,975 | 2,975 |
| Exempt insurance companies | 194 | 205 | 193 | 200 | 200 | 207 | 199 | 180 |
| Exempt insurance management companies | 38 | 38 | 38 | 36 | 32 | 33 | 31 | 30 |
| Societies with restricted liabilities ^{2/} | - | - | 14 | 32 | 65 | 97 | 144 | 166 |
| Offshore banks | 26 | 33 | 40 | 44 | 43 | 47 | 52 | 56 |
| Total | 2,904 | 3,612 | 4,137 | 5,235 | 6,021 | 6,640 | 7,256 | 7,472 |
| Memorandum items: | | | | | | | | |
| Annual increase in number of entities, ^{3/} percent | 24 | 24 | 15 | 27 | 15 | 10 | 9 | 3 |
| Offshore banks: ^{4/} | | | | | | | | |
| Total assets, percent of GDP | 124 | 254 | 401 | 749 | 786 | 818 | 839 | 1,104 |
| Profit before tax, percent of total assets | ... | 2.5 | 3.9 | 3.4 | 4.4 | 3.4 | 0.5 | 3.1 |

Sources: Central Bank of Barbados; Supervisor of Insurance; and Ministry of Industry and International Business.

1/ Active means that the license fee is paid and the entity is awaiting business.

2/ Includes total number of issued licenses. Some may not be active.

3/ Since some entities are not active, the reported increase exaggerates the increase in active entities

4/ At end-2001, offshore banks managed 800 trusts and had 298 employees.

33. *The number of offshore banks increased from 52 to 56 during 2001, while their assets increased from about 8½ times GDP at end-2000 to 11 times GDP at end-2001* (Table 3). The eight largest offshore banks account for 87 percent of total assets. Risks for depositors are, to a large extent, contained by restricting acceptance of third party deposits to offshore banks owned by qualified foreign banks (10) or well-capitalized companies (16); other offshore banks (30) are not allowed to do so.⁸ The balance sheet structure of offshore banks differs from that of commercial banks. At end-2001, investments accounted for 45½ percent of total assets and “due from head office and affiliates” 44½ percent of total assets. Equity capital was 47½ percent of total liabilities; “due to head office and affiliates,” 23 percent; long-term liabilities, 17¾ percent; and deposits 4¾ percent. After significant investment losses in 2000, return on assets again exceeded 3 percent of total assets.

C. Regulatory and Supervisory Framework

34. *Supervision has improved during the 1990s, as better legislation and prudential regulations have been adopted, but additional challenges remain.* Summary assessments of the compliance of supervisory oversight with international standards is presented in Section II. Under the Financial Institutions Act of 1996, effective July 1, 1997, the Minister of Finance is responsible for supervision, regulation, and licensing of commercial banks,

⁸Third party deposits refers deposits from persons other than a licensee’s shareholders, holding company, subsidiaries, associates, or affiliates.

trust companies, finance companies, merchant banks, and certain other nonbank financial institutions. The Act enables the Minister of Finance to delegate to the CBB certain supervisory and regulatory powers save those for granting and revoking licenses and issuing regulations. The Act establishes ownership limits for banks incorporated in Barbados, minimum capital requirements, lending limits to one borrower or group, propriety investment limits, and restrictions on connected lending. There are prudential regulations defining capital adequacy—although they only cover credit risk—loan classification and provisioning for impaired assets.

35. ***The new International Financial Services Act governing offshore banks came into effect on June 10, 2002.*** As in the case of licensees subject to the Financial Institutions Act, the supervisory authority has been assumed by the CBB. Offshore banks in practice observe the same prudential regulation regarding capital adequacy and loan classifications and provisioning as onshore financial institutions. In contrast to the previous Offshore Banking Act, the new act allows the CBB to conduct onsite inspections of offshore banks—one has already taken place.

36. ***The Cooperatives Societies Act of 1993 establishes the regulatory and supervisory framework for credit union, while day-to-day supervision is carried out by the Registrar of Cooperatives.*** Amendments to the Act calling for important changes, including prohibition for credit unions to accept deposits from nonmembers, are currently under discussion.

37. ***Supervision and regulation of the insurance sector has, hitherto, relied primarily on the good faith of industry participants which exposes the sector to significant risks.*** Recognizing that steps to formalize and improve regulation would help to protect the reputation and the charter value of the insurance business in Barbados, the Office of the Supervisor of Insurance has requested technical assistance on conducting on-site inspections through the Caribbean Regional Technical Assistance Center (CARTAC).

38. ***The Securities Act has established the Securities Commission (SC) as a new independent regulator.*** As a result, the Barbados Stock Exchange will be free from some of the regulatory functions that it has traditionally performed and will be able to focus more systematically on the development of the marketplace. The SC will address the regulatory issues which are expected to increase the transparency of the market, ensure investor protection, and promote the prudential oversight over the capital market.

IV. PERFORMANCE OF THE ONSHORE BANKING SYSTEM AND SOURCES OF VULNERABILITIES

39. ***Aggregate information as of the end of last year suggests that commercial banks are on reasonably sound financial footing.***⁹ The average capital adequacy ratio of the four locally incorporated banks increased from 14.9 percent at end-1999 to 18.2 percent at end of

⁹Banks are required to follow International Accounting Standards (IAS).

fiscal 2001 (Table 4). The lowest reported capital adequacy ratio of a locally incorporated bank was 15.1 percent in fiscal year 2001. Profits before tax have remained comfortably above 2 percent of total assets, although they declined from 2.6 percent of total assets in 1998 to 2.2 percent of total assets in 2001. All commercial banks reported profits in 2001. Net interest revenue increased by 6.2 percent during the 2001 fiscal year. Fees and other income also increased from about 23 percent to 33 percent of gross revenue during the same period.¹⁰

40. *The economic slowdown has dampened the demand for credit and its effects are also beginning to be reflected in asset quality.* Nonperforming loans increased from 3.8 percent of total loans at end-2000 to 5.0 percent at end-2001. Discussions with bank representatives indicate that banks were starting to see an increase in delinquencies and requests for restructuring of loans in early 2002. At the same time, deposits were increasing (10.2 percent in March 2002, year-on-year). While excess liquidity was at record levels and contributed to lowering the interest rates on government securities, it resulted in a smaller decline in deposit and lending rates.

41. *The 12 nonbank financial institutions with primarily domestic operations reported equity capital of 13.5 percent of total assets in 2001.* Equity capital of the least capitalized part III company was 5.7 percent of its assets. Profits before tax were 2.6 percent of total assets during the same period, with one company reporting a deficit.

Risks and Stress Tests

42. *Credit risk is the main systemic vulnerability of the onshore banking sector in the current environment.*¹¹ The economy is particularly sensitive to business cycles in the United Kingdom, United States, and Canada through their effects on the tourism sector. Tourism is also vulnerable to changes in preferences and increased competition from other destinations. The construction sector expanded significantly during the boom ending in 1999, resulting in accelerating land and real estate prices which has now subsided. A decline in these prices, due to lower economic growth, possibly through reduced demand from the offshore sector, could affect the value of banks' collateral. Finally, the manufacturing sector has been under pressure due to high costs and increased competition.

¹⁰The CBB publishes monthly aggregated summary balance sheet information of the commercial banks; PriceWaterhouseCoopers collects and publishes the annual financial statements of individual banks ([Http://www.pwcglobal.com/br](http://www.pwcglobal.com/br)).

¹¹There is also a risk for natural disasters, but Barbados is, due to its location, historically less prone to hurricanes than other countries in the Caribbean. The insurance sector is particularly vulnerable to such events, suggesting a need for diversifications of their assets across countries.

Table 4. Selected Financial Soundness Indicators for Commercial Banks, 1995-March 2002

| | 1995 | 1996 | 1997 | 1998 | 1999 | 2000 | 2001 | March 2002 |
|---|------|------|------|-------|------|------|--------------------|---------------|
| Capital adequacy ratio ^{1/} | 15.3 | 19.3 | 17.2 | 16.6 | 14.9 | 15.9 | 18.2 | 18.3 |
| Leverage (capital, percent of total liabilities) ^{1/2/} | 8.4 | 9.8 | 8.3 | 5.8 | 9.6 | 10.3 | 10.6 ^{3/} | ... |
| Off-balance sheet obligations, percent of liabilities | 5.1 | 4.3 | 2.7 | 2.6 | 3.2 | 3.3 | 3.0 ^{3/} | ... |
| Loan to deposit ratio ^{4/} | 60.0 | 51.2 | 59.1 | 65.9 | -- | 66.4 | 62.1 | 59.9 |
| Demand deposits in percent of total deposits | 27.4 | 26.5 | 32.3 | 30.7 | 29.2 | 30.5 | 29.5 | 32.8 |
| Liquid assets, percent of total assets ^{5/} | 5.8 | 9.0 | 10.8 | 6.0 | 2.5 | 5.8 | 7.4 | 9.0 |
| Excess liquidity ^{6/} | 28.0 | 44.3 | 65.2 | 34.0 | 13.8 | 30.7 | 42.8 | 52.8 |
| Total assets, annual growth rate | 14.7 | 22.5 | 8.4 | 6.9 | 9.9 | 3.6 | 10.3 | 10.8 |
| Loans and advances, annual growth rate | 4.5 | 6.1 | 22.5 | 17.0 | 12.8 | 3.8 | 0.7 | 1.8 |
| Mortgage loans, percent of loans and advances ^{7/} | 2.9 | 2.8 | 5.6 | 5.2 | 10.0 | 10.8 | 13.6 | |
| Nonperforming loans, percent of total loans ^{8/} | 12.7 | 10.1 | 6.5 | 4.5 | 3.8 | 3.8 | 5.0 | ... |
| Provisions for impaired assets, percent of assets | 2.3 | 2.0 | 1.5 | 1.2 | 1.2 | 1.2 | 1.3 | 1.2 |
| Open position in foreign exchange, percent of capital ^{9/} | 4.1 | 14.5 | 18.3 | -12.1 | 10.2 | 5.6 | 6.8 | 8.5 |
| Net foreign assets, percent of total assets | 10.5 | 14.4 | 9.8 | 7.3 | 9.3 | 6.0 | 7.5 | 7.9 |
| Deposits in foreign exchange, percent of deposits | 13.5 | 16.8 | 12.1 | 13.0 | 14.0 | 9.7 | 11.0 | 11.3 |
| Profit before tax, percent of total assets ^{3/} | 1.9 | 1.5 | 1.8 | 2.6 | 2.4 | 2.5 | 2.2 | ... |
| Total noninterest expense, percent of total assets ^{3/} | 4.6 | 4.0 | 4.1 | 4.5 | 4.1 | 4.0 | 3.7 | ... |
| Memorandum items: | | | | | | | | |
| Spread between lending rate and deposit rate ^{10/} | 6.6 | 6.7 | 6.9 | 6.9 | 6.3 | 7.0 | 8.0 | ... |
| Average interest rate on loans, advances, etc. | 11.8 | 11.9 | 11.1 | 11.1 | 11.0 | 11.9 | 11.1 | ... |
| Average interest rate on deposits | 5.2 | 5.2 | 4.2 | 4.2 | 4.7 | 4.9 | 3.1 | ... |
| Average discount rate of treasury bills | 8.3 | 5.6 | 4.9 | 5.7 | 6.1 | 3.9 | 2.0 | 1.2 |

Source: Central Bank of Barbados.

1/ Does not include branches of foreign banks.

2/ Basically tier I capital.

3/ End of 2001 fiscal year, which for some banks differs from calendar year.

4/ The loan-to-deposit ratio is calculated in this table as loans and advances as a percent of deposits. The authorities use a different definition resulting in a higher loan-to-deposit ratio.

5/ Sum of excess cash reserve requirements and excess of the statutory requirement to invest in government securities in percent of total assets.

6/ Sum of excess cash reserve requirements and excess of the statutory requirement to invest in government securities in percent of required reserves.

7/ Other loans, including personal loans, may be used to finance real estate activities. In 1999, a trust company transferred part of its loan portfolio to a commercial bank.

8/ Nonperforming loans here include loans classified as substandard, doubtful, and loss.

9/ Limits on open positions in foreign exchange only refer to so-called working balances and are reported once a week.

10/ This spread does not fully reflect the intermediation margin due to fees, commissions, etc.

43. *The CBB deserves credit for initiating stress testing of the banking system which links its macroeconomic model with the level of nonperforming loans.* Since quarterly data on nonperforming loans are only available from the beginning of 1996, the robustness of the underlying regression may not be adequate. The time series is not sufficiently long to cover the full business cycle, so that the estimated relationship reflects only the period of relatively stable growth and declining nonperforming loans. In addition, the assumptions about banks' profitability, although reasonable in light of the recent increase in fees and charges, may turn out to be optimistic bearing in mind the level of excess liquidity. The projections of the different scenarios, which are shown in Table 5, may thus err on the bright side, as suggested by the 32 percent increase in the share of nonperforming loans in 2001. Furthermore, the emphasis is on the average banking system rather than the individual banks, which, due to risk concentration to various sectors may be much more adversely affected.¹²

Table 5. Results of Central Bank of Barbados' Stress Testing

| Scenario | Change in real GDP | Change in credit to the private sector | Level of nonperforming loans (percent) | Change in nonperforming loans | Adjusted capital adequacy ratio |
|--|--------------------|--|---|-------------------------------|---------------------------------|
| Outcome in 2001 | -2.7 | 1.7 | 5.0 | 32 | 18.2 |
| Baseline for 2002 | -2.5 | 1.4 | 5.3 | 5 | 17.1 |
| Tourism receipts decline 15 percent ^{1/} | -4.8 | -2.9 | 6.7 | 33 | 16.8 |
| Construction declines 15 percent ^{2/} | -3.7 | -2.7 | 5.3 | 6 | 17.1 |
| Manufacturing sector declines 10 percent ^{3/} | -3.3 | -2.0 | 5.4 | 6 | 16.9 |
| Combination of above scenarios | -6.9 | -4.6 | 7.2 | 43 | 16.6 |

Source: Central Bank of Barbados' estimations.

^{1/} A decline in tourism receipts of 15 percent corresponds to a decline in tourism GDP by 18½ percent, which would be record low. In 2001, tourism receipts declined by 8 percent.

^{2/} In 2001, construction declined by 4 percent.

^{3/} In 2001, the manufacturing sector declined by 8 percent in 2001.

¹²As of March 2002, commercial banks' credit sectoral distribution was: personal loans 40 percent; tourism 11 percent, distribution 9 percent; professional and other services 9 percent; construction 6 percent; statutory bodies 5 percent; manufacturing 4 percent; financial institutions 4 percent; agriculture 2 percent; and other credits 10 percent. Banks' loans and advances accounted for 48 percent of local assets, and government securities for 18½ percent of total assets.

44. ***Banks' sensitivity to credit risk can also be illustrated by gauging the impact on banks' capital adequacy ratio (CAR) by an increase in nonperforming loans.*** Since the branches of foreign banks are small compared to their parents' other activities, they are excluded from this exercise. Based on data from end-2001 on loan classification, capital base (tier I plus tier II capital), and CARs, adjusted CARs are calculated for the four locally incorporated banks. The adjusted CAR reflects the impact of moving performing assets to nonperforming status. "Special mention" is included here in nonperforming loans, because recently there has been a significant increase in such loans, although they are not always so classified only on account of nonperformance. The minimum specific provision required for an asset classified as substandard is 10 percent, while the maximum provision is 100 percent for a loan classified as a loss.

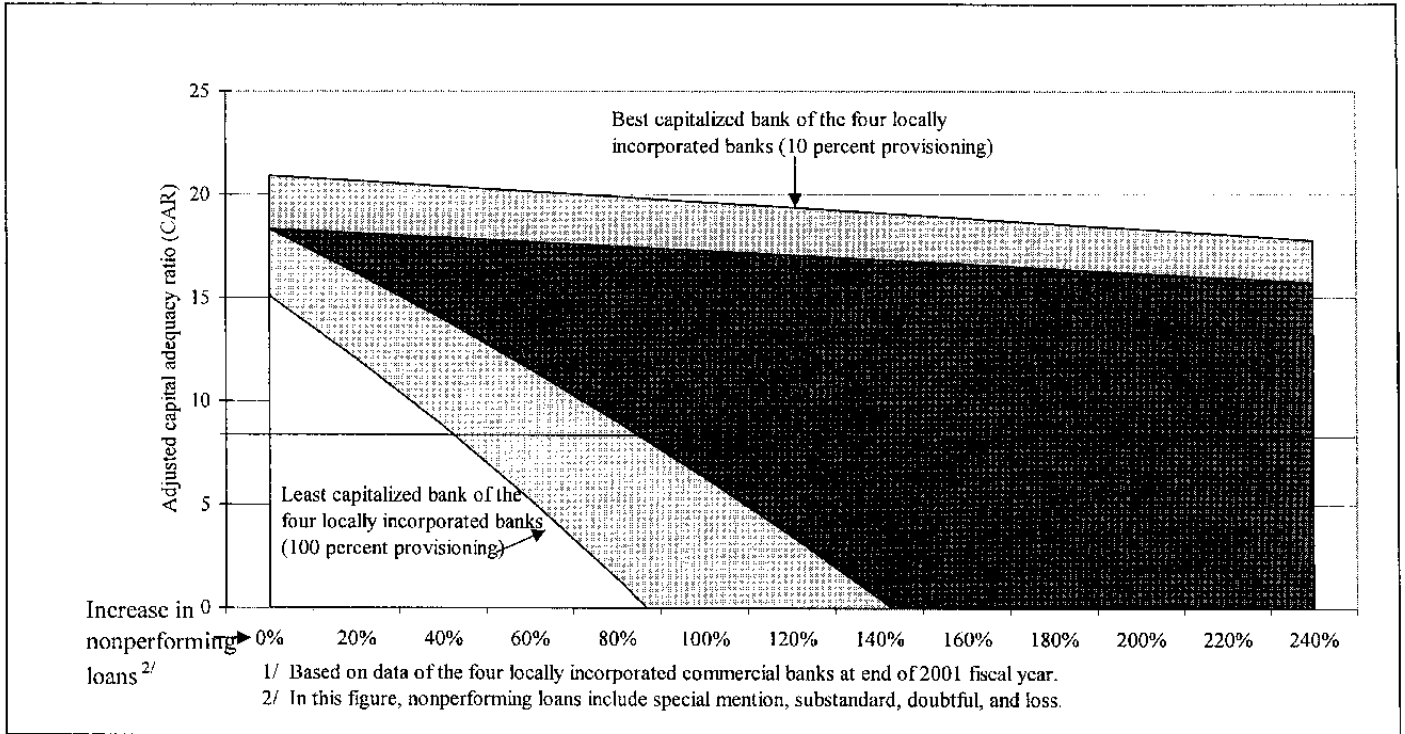
45. ***The analysis shows that on average the banking system would be able to absorb an increase in nonperforming loans by 90 percent before reaching the statutory CAR and 145 percent before becoming insolvent (Figure 1).*** While the system appears resilient, the worst-case scenario discussed above results in an increase in nonperforming loans of 43 percent. However, it is noteworthy that in the aftermath of the problems of the early 1990s, nonperforming loans at end-1995 were 2½ times higher than the current level, although they have since been resolved and banks' portfolios are now stronger and diversified. The stress test also shows that the least capitalized bank can absorb an increase in nonperforming loans of 45 percent before reaching the statutory CAR and almost 90 percent before becoming insolvent if full provisioning is required. More detailed analysis to better assess the impact of different types of shocks on individual banks would require additional data which are currently not collected.¹³

46. ***Banks are exposed to market risks, but the authorities do not consider them material in light of the pegged exchange rate arrangement, their supportive economic policies and exchange controls.*** Banks may accept deposits denominated in foreign exchange, which account for 11.3 percent of total deposits (March 2002), and are allowed to lend in foreign exchange, although such intermediation in foreign currencies is reportedly limited since it requires CBB's permission. Banks are generally allowed to have open positions in foreign exchange related to working balances of up to 15 percent of their spot liabilities.¹⁴

¹³Currently, banks report lending to different sectors, but reporting of classified loans is done on an aggregated basis. It is encouraging that the CBB is planning to collect information about loan categorization for credit to each sector, including restructuring of loans, which will allow for more detailed analysis of individual banks' vulnerability to specific economic sectors.

¹⁴If a bank has a short position in forwards, it may maintain a long spot position equivalent to 20 percent of the short position in forwards or 15 percent of spot liabilities, whichever is higher. If a bank does not have a short position in forwards, it may maintain long spot position equivalent to 15 percent of spot liabilities. Some banks have a specified nominal limit reflecting their needs. The calculation does not include options. Banks only report their position of a specific day during the week to the CBB.

Figure 1. Capital Adequacy Ratio Adjusted for an Increase in Nonperforming Loans ^{1/}



47. **While credit risk and operational costs are the main threats to bank profitability, banks are subject to some interest rate risk, which is limited by the stipulated minimum deposit rate and the maximum average lending rate for loans to the “productive sectors.”** In the event that banks’ interest expenditures were to increase from the reported average of 4 percent in 2001 to 6 percent, all other things equal, profits before tax would likely be reduced from 2.2 percent of total assets to 0.9 percent. Banks also carry a significant portfolio of government securities (19 percent of total assets, March 2002), some of which have longer maturities. Although these are typically held by banks to maturity and not for trading purposes, their value would be significantly reduced by an increase in interest rates in the event that these were marked-to-market.

48. **Due to excess liquidity in the banking system and access to the discount facility, liquidity risks are currently limited, although the position of individual banks varies over time.** Banks are also subject to operational risk, which is limited by the verification of internal controls during on-site inspections. It would be important to soon introduce measures to better monitor market risks, especially in view of the envisaged gradual capital account liberalization within the CARICOM and the establishment of FCIB with operations in jurisdictions with different exchange regimes and degrees of openness of the capital account.

V. PERFORMANCE AND RISKS IN NONBANK FINANCIAL INSTITUTIONS

A. Credit Unions

49. *The credit union sector has expanded rapidly, reaching BDS\$494 million in 2001, so that the larger institutions are now in competition with banks and require appropriate prudential supervision.* The two largest credit unions (Barbados Public Workers and City of Bridgetown) account for some 70 percent of the membership base and 64 percent of total assets of all credit unions. Because of their orientation toward small savers and for social welfare considerations, credit unions are not subject to compulsory reserve requirements and the 0.2 percent tax on total assets and the income tax.

50. *Delinquent loans continue to be a significant weakness at credit unions.* As of March 31, 2002 delinquent loans represented some 20 percent of total loans outstanding. This compares with the World Council of Credit Unions PEARLS system of financial ratios recommendation that the portfolio at risk should not exceed 5 percent of the loan portfolio.

51. *Amendments to the Cooperatives Societies Act of 1993 are currently under discussion.* Although they call for important changes, including prohibition for credit unions to accept deposits from nonmembers, the proposed amendments do not provide adequate details on financial standards aimed at protecting institutions against the risk of insolvency and for making prudential supervision more effective. In this context, it would be important for the law to allow the regulator to be able to impose timely sanctions for breaches of regulations. The authorities might consider introducing a separate credit union law or adopting common standards for deposit-taking institutions.

52. *The lack of adequate supervisory staff (six inspectors for 41 institutions) and resources have prevented the Registrar's office from attaining its objective of one on-site inspection per year.* To remedy the situation, inspections of the five largest credit unions—which account for 81 percent of the total assets of the credit unions—will in the future be undertaken jointly with the Central Bank. The first joint examination is currently underway and others will follow.

B. Insurance: Domestic and Offshore

53. *The insurance sector is an important part of the financial system and limited availability of official data make profitability and capital adequacy difficult to assess* (Tables 6 and 7). Discussions with the industry participants suggest that insurance companies have been profitable in recent years, although general insurance performance has been more volatile. Provisioning principles and capital for life insurers is self-regulated, and provisioning techniques reportedly are based, for most companies, on the Canadian system. For general insurance, the mission's discussions with the industry and analysis of unpublished data suggest that provisioning methods may be less reliable across all companies. A proposal is under consideration by the Ministry of Finance to amend the insurance legislation to enhance, among other things, capital adequacy, and solvency requirements.

Table 6. Insurance Sector: Summary Statistics

| Year | 1995 | 1996 | 1997 | 1998 | 1999 | 2000 ^{1/} |
|------------------------------------|--------|--------|--------|--------|--------|--------------------|
| Domestic sector | | | | | | |
| General Insurance | | | | | | |
| Gross written premia BDS\$ million | 185.8 | 206.9 | 205.6 | 212.6 | 242.3 | 284.3 |
| As a percent of GDP | 5.0 | 5.2 | 4.7 | 4.5 | 4.9 | 5.5 |
| Assets BDS\$ million | 149.2 | 183.1 | 184.3 | 201.3 | 239.6 | 256.5 |
| As a percent of GDP | 4.0 | 4.6 | 4.2 | 4.2 | 4.8 | 4.9 |
| Life Insurance | | | | | | |
| Gross written premia BDS\$ million | 81.5 | 92.6 | 103.2 | 119.3 | 116.3 | 115.3 |
| As a percent of GDP | 2.2 | 2.3 | 2.3 | 2.5 | 2.3 | 2.7 |
| Investment assets BDS\$ million | 354.6 | 413.1 | 360.9 | 320.8 | 352.2 | 321.4 |
| As a percent of GDP | 9.5 | 10.3 | 8.2 | 6.8 | 7.1 | 6.2 |
| Offshore Sector | | | | | | |
| Net premiums (BDS\$ billion) | 4,692 | 5,553 | 6,557 | 7,000 | 4,693 | ... |
| Assets | 27,180 | 25,720 | 25,326 | 29,756 | 31,847 | ... |

Source: Ministry of Finance. Supervisor of Insurance unpublished data.

1/ Figures for 2000 are, in some cases, not available and in other cases represent estimates.

54. ***The exposure to natural hazards in the Caribbean is an important feature of the insurance sector.*** Recent developments in risk management products may provide for some resiliency in the event of a natural catastrophe on the island. The dependence on external reinsurance for property insurance is expected to reduce gradually as companies take advantage of the recent fiscal changes making catastrophe provisions more attractive for companies to establish.

55. ***The offshore insurance sector is driven primarily by the various taxation treaties between Barbados and, in particular, the USA and Canada.*** This segment of the insurance industry has offered both a source of employment opportunities and revenue for the government through license fees, although its asset base appears to be strictly external. The presence of bilateral tax treaties allows insurance companies, after complying with the Barbadian fiscal rules, to repatriate profits net of taxes to their home country without incurring any further tax liability. Uncertainty surrounding the continuation of these taxation arrangements, which are currently being renegotiated, has led to a reduction in the number of new licenses issued. In the event that these treaties were to be withdrawn altogether the offshore market would have to rely on limited alternative advantages and, in all probability, would not be viable.

Table 7. Insurance Sector: Asset Composition
(In percent of total assets as of end-1999)

| | Life Insurance | General Insurance |
|----------------------------|----------------|-------------------|
| Bonds and debentures | 15.62 | 25.23 |
| Ordinary shares | 16.52 | 15.55 |
| Preference shares | 0.07 | 0.20 |
| Mortgages and Loans | 27.99 | 7.67 |
| Real estate and leaseholds | 8.04 | 16.68 |
| Cash balances | 6.27 | 32.85 |
| Other instruments | 25.49 | 1.82 |
| Total | 100.00 | 100.00 |

Source: Ministry of Finance Supervisor of Insurance.

56. ***The insurance supervisory and regulatory standard in Barbados has, hitherto, relied primarily on the good faith of industry participants.*** This approach exposes the sector to important risks. Single negative events may significantly damage the reputation of a jurisdiction in an increasingly regional and global market. Steps to formalize and improve regulation would help to protect the reputation and the charter value of the insurance business in Barbados from negative shocks. The Office of the Supervisor of Insurance has requested technical assistance on conducting on-site inspections through the Caribbean Regional Technical Assistance Center (CARTAC).

57. ***Insurance supervision needs more resources and redesigned processes to enforce the current provisions in the law.*** On site inspections need to be conducted and supported by a more analytical rather than compliance oriented off site analysis. This, in turn, will require better information collection. While full compliance with all requirements of supervisory independence under the IAIS principles may be difficult, independence of the supervisor needs to be enhanced. Supervisory independence should be supported by greater transparency and public reporting.

C. Capital Market Issues

58. ***Given their limited activity, securities markets appear to present little systemic risk to the financial sector.*** As of July 2002, there were 25 issues traded on the Barbados Stock Exchange (BSE) regular market, and 2 funds traded on the junior market. Market capitalization as of year-end 2001 was approximately US\$1.8 billion or 71 percent of GDP (Table 8), but the volume of transactions has remained extremely low. Over the last three years, the liquidity ratio, given by the ratio of trades in the regular market over stock market capitalization, has never exceeded half of a percentage point. The liquidity of the market suffers from the limited diversification opportunities offered by the size of the economy and from the ownership concentration. The increased transparency and the clearer regulatory

framework introduced with the new Securities Act should help to enhance the role played by the BSE.

Table 8. BSE: Main Indicators, 1999–2001

| | 1999 | 2000 | 2001 |
|---------------------------------------|--------|--------|--------|
| Number of listed companies | 20 | 20 | 25 |
| Number of brokers | 8 | 8 | 8 |
| Capitalization (millions of BDS\$) | 4015.3 | 3379.1 | 3656.2 |
| Capitalization (in percent of GNP) 1/ | 80.8 | 65.0 | 70.7 |
| Turnover (millions of BDS\$) | 40.6 | 95.8 | 20.3 |
| Regular market | 23.5 | 14.0 | 12.4 |
| Liquidity Ratio (in percent) 2/ | 0.5 | 0.4 | 0.3 |
| Memorandum items: | | | |
| GDP (millions of BDS\$) | 4970 | 5200 | 5173 |

Source: Annual reports and website of the BSE

1/ Capitalization of listed stocks.

2/ Ratio of turnover on the regular market (net of pass through trades) over stock market capitalization.

59. ***The low level of activity and the size of the Barbadian market underscore the need to consider the development of stock market activities in a regional context.*** The limited volume of activity is a common feature of all the stock exchanges of the region. The few diversification opportunities offered by each individual market constrains the demand for investments and the volume of trades, keeping low the revenues of market intermediaries and the amount of resources directed toward the stock market. A reduction of fixed costs and an increase in the number of listings can result from the adoption of common listing, trading and settlement rules within the region, and from removal of the restrictions on investments in the stock exchanges of the region.

VI. FINANCIAL SAFETY NETS AND CRISIS MANAGEMENT

60. ***The potential for financial instability may be contained by a well designed deposit insurance scheme in a properly supervised banking system.*** In October 2002, the authorities announced plans to introduce a compulsory deposit insurance scheme for institutions licensed under the Financial Institutions Act. At present, the government guarantees the deposits of the state-owned bank (BNB), which will be phased out over a two- to three-year period, while new deposits will be covered by the new scheme. It is contemplated that the level of coverage will be related to GDP per capita, similar to that in other countries in the region. The premium will initially be uniform. The corporation will also be able to borrow with a guarantee from the CBB or the government.

61. ***An appropriately designed deposit insurance scheme protecting small depositors could contribute to financial stability by reducing the risk of runs on banks.*** However, this

requires a careful tailoring of the system that minimizes moral hazard and the political temptation to expand its scope. Given the size of the financial sector, it may be desirable to consider a simple system along the lines of a “pay box” whereby the administering entity only collects the premiums and makes payments to eligible depositors. The scheme should not include any provision that could allow the coverage of deposits with financial institutions that do not contribute to the scheme. This is particularly important in light of the present weaknesses of credit unions among nonbank deposit taking institutions. If credit unions are to be covered de facto, they should come under the same degree of supervision as commercial banks. Since, in the event of insufficient funds, the corporation will be allowed to borrow from the CBB or the MoF, it would be important that government rather than the CBB accepts this risk.

62. ***The CBB is the lender-of-last-resort.*** Since most of the banks are foreign owned, they are expected to rely on parent resources for emergency assistance. The authorities indicated that any lender-of-last resort liquidity support would be provided to commercial banks on a case-by-case basis. They are of the view that any adverse developments in a bank would be reflected in its frequent resort to the discount window. This would provide the CBB ample opportunity to pursue corrective actions at the concerned bank. In recent years, there has been no such emergency lending. Commercial banks may borrow from the CBB through discount facility for their short-term liquidity needs, but banks have not used this facility for a long time. The interest rate on such borrowing is currently set at 7.5 percent and lending is collateralized by government securities. There is no explicit individual or aggregate quota on the use of this facility.

63. ***The significant foreign ownership of the banking system provides some assurances of support by the parent in the event of distress.*** Recent examples of parents walking away from a subsidiary, however, suggest that the CBB should not fully rely on parent support. The CBB should revisit the need for contingency plans in light of the experience gained during the takeover of BCCI’s activities in Barbados (which became the Mutual Bank).

64. ***The legislation delegates authority to the CBB to control and seize the administration of a licensee for its reorganization or its compulsory winding-up under specified circumstances.***¹⁵ The Financial Institutions Act, however, includes provisions that could prevent speedy action and thus increase the risk for erosion of the assets of the institution. It is unclear if the CBB can fully control the operations during the appeal period. Reorganization is currently subject to court determination. While checks and balances must be in place to ensure the rule of law, it is also important that reorganization and compulsory winding-up procedures, which currently require complicated and time consuming court proceedings with an appeal process, do not prolong the resolution of a distressed bank situation. These provisions are expected to, and should be, reviewed in context with the introduction of deposit insurance. A more proactive approach may be facilitated if prompt corrective action provisions were to be introduced.

¹⁵The CBB uses an internal note for handling distressed banks including seizure and control.

VII. OTHER ISSUES

A. Transparency and Disclosure Practices

65. *An assessment of observance of the IMF's Code of Good Practices on Transparency in Monetary and Financial Policies found that overall transparency practices regarding the CBB's monetary policy are very good.* The monetary policy process is well structured and open. The procedures and practices governing the instruments of monetary policy are adequately disclosed through various publications and other means, including the monthly *Economic and Financial Statistics*, the CBB's *Annual Report*, the *Annual Statistical Digest*, the *Economic Review*, other publications, and its website.

66. *With respect to transparency in financial policies, while observance is generally high in banking, it could be strengthened in other nonbanking areas.* Barbados starts with the considerable advantage that much of the legislation supporting the supervisory infrastructure is sound. The new Securities Act, and the International Financial Services Act, provide good foundations, but some amendments may be needed to *The Financial Institutions Act* to match the *IFSA* and the *Central Bank of Barbados Act* to provide for the disclosure of prudential supervision of the payments system. Also, since the Securities Commission is just getting established, there is yet to be adequate transparency of its regulations and procedures. The *Insurance Act* and its administration are opaque and changes to make the operations of the Office of the Supervisor of Insurance transparent could be useful.

B. Anti-Money Laundering (AML) and Combating the Financing of Terrorism (CFT)

67. *Barbados has worked hard to develop an effective regime for anti-money laundering and combating the financing of terrorism.*¹⁶ The Money Laundering (Prevention and Control) Act ("MLPCA") was enacted in 1998 and amended in 2002; the Anti-Terrorism Act was enacted in 2002; the Mutual Assistance in Criminal Matters Act was amended in 2001; and Know Your Customers Guidelines have been issued for all financial services providers. The institutional structure has also been strengthened in 2000 with the creation of the Anti-Money Laundering Authority ("AMLA"). The AMLA is charged with ensuring compliance by all financial institutions with the AML/CFT requirements.

68. *The AMLA is well organized and functions through its supervisory board (SB).* The SB consists of representatives from the Commissioner of Police, Inland Revenue, Customs authorities, Supervisor of Insurance, Corporate Affairs and Intellectual Property Office, Central Bank, and the Solicitor General's office. The Financial Intelligence Unit ("FIU") conducts AMLA's day-to-day activities. It receives, analyzes and disseminates pertinent financial information and intelligence and investigates suspicious transactions. The FIU has

¹⁶ The mission's assessment is based on the draft AML/CFT methodology developed by the IMF and the World Bank.

developed a networking mechanism through the organization of an Intelligence Committee (IC) to enhance cooperation among the authorities. The IC is comprised of the government entities represented on the SB plus the Registrar of Cooperatives, Director of International Business and the Immigration Department. The FIU meets the Egmont Group's definition and Barbados was recently admitted to Egmont membership at its annual meeting June 5, 2002

69. ***Given the FIU's limited staff, it cannot be realistically expected to assess compliance in the entire financial sector.***¹⁷ Thus, it relies heavily on the supervisory authorities of various financial institutions. This approach is complemented by the networking mechanism and seems to work well in the domestic banking sector, supervised by the Central Bank of Barbados.

70. ***AML/CFT supervision of offshore banking has commenced.*** The Central Bank of Barbados has conducted some off-site compliance reviews and initiated an on-site inspection program in the offshore banks. In view of the risk posed by money laundering in the offshore banking sector, it appears prudent to proceed expeditiously with the implementation of such a program to ensure AML/CFT compliance.

71. ***Effective supervision in the insurance and the capital markets sectors is only now getting off the ground.*** AML/CFT compliance programs are also needed in these sectors and should be implemented in line with the appropriate risks for these industries. Currently there is little activity in the securities sector and the risk of money laundering may not be as significant as in some other financial institutions.

72. ***Another area of concern is the apparent lack of an effective process for AML/CFT prevention in the credit union sector.*** The Registrar's office has not conducted AML/CFT onsite inspections until recently when its staff began joint inspections with the Central Bank of Barbados in some of the larger credit unions. The CBB's involvement in this program will be ongoing and will, in association with the Financial Intelligence Unit, include training of staff for assessing observance of AML/CFT guidelines. Although it will commence inspections of small and medium sized credit unions as soon as feasible, the circumscribed nature of the activities and membership of the credit unions are a deterrent for money laundering through this channel.

73. ***The AMLA and the financial regulators should consider alternatives in light of the risks that money laundering poses in these areas.*** The AMLA could, as an interim measure, require that regulators request written reports from the respective entities they supervise in order to assist in determining compliance with AML/CFT requirements.

¹⁷The FIU is staffed with a director, four analysts, and one support staff.

SECTION II: SUMMARY ASSESSMENTS OF THE OBSERVANCE OF FINANCIAL SECTOR STANDARDS

This section of the Financial System Stability Assessment for Barbados contains information on the observance of international standards and codes relevant for the financial sector. The assessment has helped to identify the extent to which the supervisory and regulatory framework is adequate to address the potential risks in the financial system. It also provides an assessment of the transparency practices regarding monetary and financial policy.

As part of the FSAP, the following detailed assessments of standards were undertaken: Basel Core Principles for Effective Banking Supervision: Messrs. Keith Bell (external expert, formerly with the Office of Superintendent of Financial Institutions, Canada) and Tonny Lybek (IMF); the International Organization of Securities Commission (IOSCO) Objectives and Principles of Securities Regulation: Ms. Melinda Roth (World Bank); the Committee on Payment and Settlement Systems (CPSS) Core Principles for Systemically Important Payment Systems (CPSIP): Mr. Robert Keppler (World Bank); the International Association of Insurance Supervisors (IAIS) Insurance Supervisory Principles: Mr. Craig Thorburn; and the IMF's Code of Good Practices on Transparency in Monetary and Financial Policies; Messrs. Vassili Prokopenko (IMF) and Carlisle Proctor (external expert, formerly with the Reserve Bank of Australia). The assessments were based on the authorities' answers to questionnaires and work during the FSAP mission during June 24 to July 12, 2002.

Barbados' compliance with international supervisory standards is generally high, especially in the onshore and offshore banking sectors. The establishment of the Securities Commission under the *Securities Act* paves the way for strengthened supervision of securities markets. Considerable weaknesses are identified in the insurance area where there is a pressing need to strengthen supervision both in the onshore and offshore segments of the industry. Transparency practices regarding monetary and financial policies are generally in line with best practices. Reflecting supervisory weaknesses, transparency practices are also deficient in the insurance sector.

I. COMPLIANCE WITH THE BASEL CORE PRINCIPLES FOR EFFECTIVE BANKING SUPERVISION

A. Commercial Banks and Part III Companies

Main Findings

74. Many of the Core Principles for Effective Supervision of commercial banks and part III companies are either "compliant" or "largely compliant." Only 2 principles are not compliant, of which currently one is of limited importance. The representatives of the Bank Supervision Department (BSD) are fully aware of the remaining weaknesses in the existing legal framework and procedures.

Preconditions for effective banking supervision and CP 1

75. The legal, business, and accounting framework in which licensees operate and supervision takes place are generally sound and well established. The supervisory authority has extensive powers to control the risks assumed by licensees. The required involvement of the Minister of Finance in certain regulatory actions could compromise the CBB's judgments in certain situations and impact its independence. While the Minister has the power to delegate any of his or her supervisory and regulatory functions under the FIA to the CBB (save those for licensing and revocation of licenses), it has not formally been done. Moreover, under the FIA, the Minister has substantial powers to establish prudential safety and soundness regulations. To date, these powers have not been used extensively. Senior management of the supervisory authority is confident that it possesses an adequate number of qualified staff to provide timely, comprehensive onsite and offsite supervision to the present number of licensees. However, it is also cognizant that a growing, diverse group of financial institutions, coupled with developments in the industry, will bring forth the necessity of additional resources.

Licensing and structure, CPs 2-5

76. The FIA defines the term 'bank' as "a company carrying on the business of banking." The latter term is defined, in circular fashion in part, as 'generally the undertaking of any business appertaining to the business of banking provided that such business has not been specifically prohibited by the Central Bank.' While such a definition imparts flexibility, it requires that licenses be precisely drawn and that supervision be timely. The FIA prohibits use of the term 'bank' and its derivatives except by institutions regulated by the CBB as banks. The criteria for establishing licensees and approving the scope of their operations are thorough and include the appropriate considerations. Mergers of licensees (by either share acquisition or transfer of undertaking) are subject to the prior approval of the Minister. While the CBB has the authority to review and give prior approval to the proposed establishment, by licensees, of branches, representative offices or subsidiaries (and to consider the risks involved for the licensee and to the supervisory interests of the CBB), it does not have the power to review and give prior approval to significant corporate acquisitions by licensees.

77. There must be prior review and approval by the Minister of the proposed acquisition of a shareholder interest above the threshold level of 20 percent of the value of the stated capital of an institution incorporated in Barbados and licensed pursuant to the FIA, which is comparatively high.

Prudential regulations and requirements, CPs 6-15

78. The CBB has imposed a minimum eight percent capital adequacy ratio of risk-weighted assets, but the CBB's capital adequacy requirements do not yet embrace market risk-related computations, capital charges, or detailed reporting requirements

79. A regulation establishing procedural requirements for asset quality classification and provisioning has been issued and provides substantive guidance to licensees' credit operations. However, while it does have a set of guidelines for its own internal use in monitoring the financial condition of licensees, the CBB has not issued guidelines and regulations that provide licensees comprehensive instructions and requirements for lending and investment policies and procedures (including credit concentrations and connected lending), the related internal control systems, or for country, market and transfer risk (CPs 7-11). Regarding risk management process, the CBB has not yet introduced internal control, risk management, and corporate governance regulations (CP 13).

80. The CBB requires that licensees maintain adequate internal control systems and appoint competent external auditors who evaluate and report on the adequacy of internal controls in the conduct of the annual audit. The CBB determines that such systems are in place and competent, independent auditors make that independent assessment of such controls during its onsite inspections. Given its present level of inspection resources and the number of licensees, the CBB's target is to conduct an onsite inspection of each licensee every 18 to 24 months (CP 14).

81. The CBB has introduced a know-your-customer guideline, in keeping with the international standards of the Financial Action Task Force (FATF), to enforce the control of money laundering. Compliance on money laundering is evaluated at the onsite inspections and licensees are required to report suspicious transactions to the Financial Intelligence Unit (FIU) (CP 15).

Methods of ongoing supervision, CPs 16-20

82. The CBB performs both onsite and offsite supervision. Comprehensive and targeted onsite inspections are planned in consultation with the offsite supervision unit and conducted using standardized written procedures. The BSD generally performs their functions effectively based on appropriate procedures. The BSD's senior management is confident that the human resources that are devoted to supervision are adequate to ensure timely and comprehensive supervision to the present number of licensees. However, it is also cognizant that a growing, diverse group of financial institutions, coupled with development in the industry, will bring forth the necessity of additional resources (CP 16).

83. The BSD plans to initiate regular meetings with management of FIA licensees, which will supplement meetings held during the onsite examination cycle. Regularly scheduled discussions with the external auditors of licensees are not yet a normal part of the supervisory process, but the BSD meets annually with external auditing firms to discuss regulatory issues generally (CP 17). The CBB has full authority to request and access any information needed in the exercise of its supervision. The various prudential reports are submitted by licensees in hard copy or 'disk' format for subsequent entry into the CBB's data system. They are reviewed, analyzed, and followed up with each licensee's management by the offsite supervision unit on an as-required basis (CP 18). In addition to its onsite inspections, the CBB can use the reports of the licensees' external auditors, or external auditors specially

appointed by the CBB, as significant sources of supervisory information. Licensees are required to designate as their external auditor a member of an auditing association approved by the CBB. The external auditor of a licensee is obligated to report to the CBB where the auditor believes that there has been non-compliance with the requirements of the license or the governing statute and regulations (CP 19).

84. The CBB practices direct and indirect supervision, including onsite inspection, offsite surveillance, and prudential reporting, and imposes its prudential standards on a consolidated basis for all of the locally-incorporated licensees within its jurisdiction, including their subsidiaries and foreign operations, although they may not report quarterly on a consolidated basis (CP 20).

Information requirements, CP 21

85. Licensees are required to prepare prudential and other financial information and other reports in accordance with appropriate international accounting standards. Public disclosure requirements are in place. The CBB ensures that information provided from licensees' records is verified periodically through onsite inspections. There is no requirement that the external auditors verify such information.

Remedial measures and exit, CP 22

86. The CBB has authority to pursue a series of graduated remedial measures in the event that a licensee has supervisory problems or fails to comply with prudential regulations, or infracts one of the CBB's internal guidelines. The CBB has been generally successful in obtaining prudential compliance and correction of matters requiring attention through its ongoing supervisory communications with licensees, without the necessity to invoke the use of sanctions and penalties. The Minister must approve certain remedial actions.

Cross-border banking, CPs 23-25

87. The CBB has the authority to supervise the overseas operations of locally incorporated licensees. The BSD recognizes that it will have to include examinations of overseas establishments of licensees' activities in its ongoing supervisory process (CP 23). Supervisory information is exchanged, as appropriate, with foreign home and host country supervisory authorities through ongoing informal contacts, as necessary (CP 24). The CBB enforces the same supervisory policies and standards, as appropriate, on the operations of foreign banks in Barbados, as are required for locally incorporated institutions (CP 25).

Table 9. Summary of Main Findings of Assessment of Implementation of the Basel Core Principles for Commercial Banks and Part III Companies

| CPs Main Categories | Main Findings |
|--|---|
| Objectives, Autonomy, Powers, and Resources (CP 1) | The supervisory authority has extensive powers to control the risks assumed by licensees. The required involvement of the Minister of finance in certain regulatory actions could compromise the CBB's judgments in certain situations and impact its operational independence. The Minister has substantial powers to establish prudential safety and soundness regulations, but these powers have not been used extensively. It is the practice that the Minister accepts the advice of the CBB on regulatory matters. Senior management of the supervisory authority is confident that it possesses an adequate number of qualified staff to provide timely, comprehensive onsite and off site supervision to the present number of licensees. However, it is also cognizant that a growing, diverse group of financial institutions, coupled with developments in the industry, including the creation of one large conglomerate, will bring forth the necessity of additional resources. |
| Licensing and Structure (CPs 2-5) | The <i>Financial Institutions Act</i> (FIA) defines the term 'bank' as "a company carrying on the business of banking." The latter term is defined, in circular fashion in part, as 'generally the undertaking of any business appertaining to the business of banking provided that such business has not been specifically prohibited by the Central Bank'. While such a definition imparts flexibility, it requires that licenses be precisely drawn and that supervision be timely. The FIA prohibits use of the term 'bank' and its derivatives except by institutions regulated by the CBB as banks. The criteria for establishing licensees and approving the scope of their operations are thorough and include the appropriate considerations. The required minimum capital is BDS\$4 million for commercial banks and BDS\$2 million for finance and trust companies and merchant banks. Mergers of licensees (by either share acquisition or transfer of undertaking) are subject to the prior approval of the Minister. There must be prior review and approval by the Minister of the proposed acquisition of a shareholder interest above the threshold level of 20 percent of the value of the stated capital. |
| Prudential Regulations and Requirements (CPs 6-15) | The capital adequacy ratio is eight percent of risk-weighted assets, but only credit risk is included, market risks are not yet covered. A regulation establishing procedural requirements for asset quality classification and provisioning has been issued and provides guidance to licensees' credit operations. The CBB requires that licensees maintain adequate internal control systems and appoint competent external auditors who evaluate and report on the adequacy of internal controls in the conduct of the annual audit, which is checked during onsite inspections. The CBB has introduced a know-your-customer guideline. |
| Methods of Ongoing Supervision (CPs 16-20) | The CBB performs both on site (the targeted cycle is 18 to 24 months but has been impacted by Y2K and AML inspections) and off site supervision. The CBB units that are responsible for on site inspections and off site surveillance generally perform their functions effectively. Formal, regular contact between the CBB and the management and external auditors of licensees has <u>not</u> been an integral part of the on site and off site supervisory processes, but has now been initiated. The CBB practices consolidated supervision annually. |
| Information Requirements (CP 21) | Licensees are required to prepare prudential and other financial information and other reports in accordance with appropriate international accounting standards. Public disclosure requirements are in place. Data are verified periodically through on site inspections. |
| Formal Powers of Supervisors (CP 22) | The CBB can impose graduated remedial measures in the event that a licensee has supervisory problems or fails to comply with prudential regulations, or infracts one of the CBB's internal guidelines. The CBB has been generally successful in obtaining prudential compliance and correction of matters requiring attention through its ongoing supervisory communications with licensees, without the necessity to invoke the use of sanctions and penalties. The Minister must approve the use of certain remedial actions. |
| Cross-border Banking (CPs 23-25) | The CBB has the authority to supervise the overseas operations of locally incorporated licensees. Supervisory information is exchanged, as appropriate, with foreign home and host country supervisory authorities through ongoing informal contacts, as necessary. However, to date, no Memoranda of Understanding (MOU) have been concluded, but a draft has been circulated for comments by other regulators. The CBB enforces the same supervisory policies and standards, as appropriate, on the operations of foreign banks in Barbados, as are required for locally incorporated institutions. |

Authorities' Response and Next Steps

88. The authorities broadly agree with the assessment and recommendations with two important exceptions. They do not agree that the required involvement of the Minister in certain regulatory actions mentioned under *General Preconditions for Effective Banking Supervision* and in the assessment of Core Principle 1 could compromise the CBB's judgments in certain situations and impact its independence. Instead, they see intervention by the Minister of Finance and the Governor of the CBB in exceptional cases as one way to resolve difficult situations before initiating timely and costly legal procedures. The Bank Supervision Department ensures that banks make appropriate provisions.

89. Furthermore, the authorities are generally concerned that the assessors have not adequately appreciated the level of sophistication of the financial system under review. The exchange controls, for instance, limit banks' lending abroad, and together with interest controls, they reduce market risks. Accordingly, the authorities argue that the rating of CP 6 and CP 12 are harsh and should be revised upwards, while CP 11 should be assessed as "not applicable."

90. The authorities agree with the assessors' recommended actions to address the identified weaknesses. Most of the recommendations will be addressed during the envisaged review of the Financial Institutions Act, while new regulations and guidelines will address remaining issues.

B. Offshore Banks

Main Findings

91. Offshore banks are exempt from exchange controls, and some are not allowed to accept third party deposits. In contrast to the former *Offshore Banking Act*, the newly adopted IFSA explicitly enables the CBB to conduct onsite examination of offshore banks.

92. Many of the Core Principles for Effective Supervision of offshore banks are either "compliant" or "largely compliant." Thus, only 2 principles are "not compliant." The representatives of the Bank Supervision Department are fully aware of the remaining weaknesses in the existing legal framework and procedures.

Preconditions for effective banking supervision and CP 1

93. The recently enacted IFSA provides powers, almost identical to the FIA, to the Minister of finance, who has delegated the supervisory and regulatory functions to the CBB, save those for licensing, revocation, and cancellation of licensees, and establishing regulations.

Licensing and structure, CPs 2-5

94. The terms “international financial services” and “bank” are protected in the IFSA. The IFSA requires the Minister’s prior review and approval of a proposed acquisition above the threshold level of 10 percent of the value of the stated capital of a licensee (in contrast to 20 percent in the FIA).

Prudential regulations and requirements, CPs 6-15

95. All licensees subject to the IFSA have been asked to abide by the four regulations made under the FIA (capital adequacy ratio, loan categorization and provisioning, financial statements, and fees). CBB’s capital adequacy requirements do not yet embrace market risk-related computations. Other risks will be reviewed during onsite inspections.

Methods of ongoing supervision, CPs 16-20

96. The CBB performs offsite supervision, and has just begun to conduct onsite inspections with the enactment of the IFSA. In contrast to FIA licensees, regular annual meetings with IFSA licensees, occasionally together with the external auditor, ensures regular contact between the CBB and the management. Moreover, in contrast to the FIA, a licensee’s external auditor is subject to prior approval by the CBB. Both the FIA and the IFSA require that the external auditor of a licensee report to the CBB where the auditor believes that there has been non-compliance with the requirements of the governing statute and regulations or the conditions of the license.

Information requirements, CP 21

97. IFSA licensees are required to prepare prudential and other financial information and other reports in accordance with international accounting standards or their parent’s accounting standards. Public disclosure requirements are in place. The CBB will now ensure that information provided from licensees’ records is verified periodically through onsite inspections. There is no requirement that external auditors verify such information.

Remedial measures and exit, CP 22

98. The IFSA authorizes the CBB to pursue a series of graduated remedial measures in the event that a licensee has supervisory problems or fails to comply with prudential regulations, or infracts one of the CBB’s internal guidelines. The CBB has been generally successful in obtaining prudential compliance and correction of matters requiring attention through its ongoing supervisory communications with licensees, without the necessity to invoke the use of sanctions and penalties. The Minister must approve the use of certain remedial actions.

Cross-border banking, CPs 23-25

99. The CBB has the authority to supervise the overseas operations of locally incorporated IFSA licensees. In isolated instances, the CBB has conducted onsite examinations of the overseas establishments of IFSA licensees and recognizes that it will have to include these activities in its ongoing supervisory process. Supervisory information is exchanged, as appropriate, with foreign home and host country supervisory authorities through ongoing informal contacts, as necessary.

Table 10. Summary of Main Findings of Assessment of Implementation of the Basel Core Principles for Offshore Banks

| CPs Main Categories | Main Findings |
|--|--|
| Objectives, Autonomy, Powers, and Resources (CP 1) | The IFSA requires involvement of the Minister of Finance in certain regulatory actions, which could compromise the CBB's operational independence. The IFSA provides powers, almost identical to the FIA, to establish regulations to the CBB directly. To-date, the CBB has not issued any regulations under that statute, although all licensees subject to the IFSA have been asked to abide by the four regulations made under the FIA. The term "bank" and "international financial services" are protected. |
| Licensing and Structure (CPs 2-5) | The criteria for establishing licensees and approving the scope of their operations are thorough and include the appropriate considerations BDS\$4,000,000 (similar to a commercial bank) or BDS\$1,000,000 if the licensee does not accept third party deposits. Mergers of licensees (by either share acquisition or transfer of undertaking) are subject to the prior approval of the Minister. There must be prior review and approval by the Minister of the proposed acquisition of a shareholder interest above the threshold level of 10 percent of the value of the stated capital of an IFSA licensee. |
| Prudential Regulations and Requirements (CPs 6-15) | IFSA licensees are subject to the same capital adequacy ratio as FIA licensees, namely, eight percent of risk-weighted assets, but market risks are excluded. A regulation establishing procedural requirements for asset quality classification and provisioning has been issued and provides substantive guidance to licensees' credit operations. The CBB requires that licensees maintain adequate internal control systems and appoint competent external auditors who evaluate and report on the adequacy of internal controls in the conduct of the annual audit. The CBB has introduced a Guideline, in keeping with the international standards consistent with the Financial Action Task Force (FATF), to enforce the control of money laundering. |
| Methods of Ongoing Supervision (CPs 16-20) | The CBB performs offsite supervision (quarterly prudential reports submitted within 21 days) and has initiated both comprehensive and targeted onsite inspections. The CBB units that are responsible for onsite inspections and offsite surveillance generally perform their functions effectively based on appropriate procedures. Annually, the CBB meets with management of the IFSA licensees. The CBB has full authority to request any information needed in the exercise of its supervision. |
| Information Requirements (CP 21) | IFSA licensees are required to prepare prudential and other financial information and other reports in accordance with IAS or accounting standards of their parent. Audited annual financial statements are published. The CBB ensures that information provided from licensees' records is verified periodically through onsite inspections. The IFSA grants the CBB the power to appoint an auditor to examine prudential returns submitted by a licensee. |
| Formal Powers of Supervisors (CP 22) | The IFSA, like the FIA, authorizes the CBB to pursue a series of graduated remedial measures in the event that a licensee has supervisory problems or fails to comply with prudential regulations, or infracts one of the CBB's internal guidelines. The CBB has been generally successful in obtaining prudential compliance and correction of matters requiring attention through its ongoing supervisory communications with licensees, without the necessity to invoke the use of sanctions and penalties. The Minister approves the use of certain remedial actions. |
| Cross-border Banking (CPs 23-25) | The CBB has the authority to supervise the overseas operations of locally incorporated IFSA licensees. In isolated instances, the CBB has conducted onsite examinations of the overseas establishments of licensees. Supervisory information is exchanged, as appropriate, with foreign home and host country supervisory authorities through ongoing informal contacts, as necessary. |

Authorities' Response and Next Steps

100. The CBB generally agrees with the assessment and recommendations. Regulations will be issued to: (i) introduce capital requirements for market risks; (ii) provide guidance on country and transfer risks; and (iii) introduce an aggregate limit for large exposures. Guidelines for corporate governance are currently being prepared. The Handbook and the Manual will be revised to reflect current practices.

II. COMPLIANCE WITH THE CPSS CORE PRINCIPLES FOR SYSTEMICALLY IMPORTANT PAYMENT SYSTEMS

A. General

101. An assessment of the stability, efficiency, and soundness of payment system activities according to the CPSS *Core Principles for Payment Systems* was undertaken under the auspices of the IMF-World Bank Financial Sector Assessment Program (FSAP), based on information up to July 2002. The assessment was conducted by Mr. Robert Keppler (World Bank).

Information and methodology

102. Payment systems in Barbados are in transition and two newly designed automated systems are being implemented. These are an automated clearing (ACH) system to process truncated checks and a modern automated Real Time Gross Settlement System--owned and operated by the Central Bank of Barbados (CBB)--to process large value credit transfers and other time critical credit transfers. Initially, the ACH system will process low value checks. Settlement of ACH clearing balances will take place through the RTGS system twice per day. Other systems, such as the funds transfer leg of the stock exchange system, will also settle through the RTGS system. From the outset, the RTGS system has been designed to satisfy the CPSS Core Principles. It is estimated that some 1,500 transactions per day will be processed via the RTGS system. This represents approximately 5 percent of the typical daily volume of all payment transactions and approximately 70 percent of the total daily value of such transactions. As the ACH system will process low value payments, it is not considered to be a systemically important payment system.

103. The RTGS system is a systemically important payment system. The assessment is based on a comprehensive set of system and user documentation provided by the CBB. This includes technical system design documentation, user training documentation, commercial bank and accountant general operational procedures, security procedures including failure recovery and contingency planning procedures, relevant S.W.I.F.T. documentation, operational readiness check lists, participant terms and conditions (contractual arrangements between participants and the central bank relating to the provision of settlement accounting services), a legal opinion from the CBB's external legal counsel, a description of the Virtual Private Network (VPN) system access policy which will be used by participants to connect with the central bank systems, and miscellaneous project documents including a draft CBB Board Paper describing the envisaged cost recovery and pricing policy, and a draft public policy document "The Role of the Central Bank in Payment Systems." These sources were supplemented with several discussions held with officials of the central bank and with the CBB's external legal counsel.

B. Institutional Setting and General Pre-conditions

104. All licensed commercial banks are eligible for participation in the RTGS system. In addition, transactions relating to government activities under the control of the accountant

general will be processed via the system. The RTGS system has real time links to the central bank general ledger system (Prophecy); thus all transactions that have an impact on a participants' position in the books of the central bank will be reflected in a timely manner in the settlement accounts maintained in the RTGS accounting module. This is a major feature of the system and provides real-time access to current account balances for commercial bank treasurers and accountant general staff. Participants will have real time tools to assist them to proactively manage their payments queues and thus optimize the use of liquidity available to them. In addition, the system has a range of gridlock busting mechanisms that allows appropriate bi-lateral or multilateral off-set arrangements to be invoked to further optimize the use of system liquidity. In summary, the RTGS functionality is similar to that observed in advanced economic markets such as member states of the European Union.

105. Barbados is a relatively small banking system that cannot afford expensive infrastructure. This was recognized at the outset of the RTGS project and steps were taken to acquire the necessary information technology infrastructure and specialized RTGS software at acceptable levels of cost - both initial cost and on-going operational costs. For security reasons and to reduce project risk a decision was made to use the S.W.I.F.T. Fin-system (V-Copy configuration) for submitting and receiving payments instructions. However, to minimize SWIFT message costs, all nonvalue messaging such as account balance monitoring inquiries, and payments queue management, will be undertaken via browser based software installed in participant work stations that access the relevant RTGS servers via the central bank VPN services.

106. Legal opinions were sought from the external legal advisers to the central bank on all substantial matters that relate both to the central bank's role in establishing an RTGS system as well as critical issues such as; a) finality and irrevocability of RTGS payments, b) the degree to which the RTGS system is insulated from the provisions of the Barbados Insolvency Act; and c) the consistency of the proposed Terms and Conditions (Participant Contracts) with existing legislation including the Arbitration Act. Barbados has already enacted an Electronic Transactions Act that provides legal validity to electronic records and digital signatures. The Evidence Act has also been amended to ensure that electronic features are acceptable as evidentiary material in judicial matters. There are no substantial legal impediments to regarding the implementation of the RTGS system.

107. The following assessment of the RTGS system design and envisaged operational arrangements is based on the Guidance Note for Observance of Core Principles for Systemically Important Payment Systems (CPSIPS) issued by the International Monetary Fund and the World Bank in August 2001.

Table 11. Main Findings of the Assessment of the Observance of CPSS Core Principles for Systemically Important Payments Systems—Central Bank of Barbados RTGS System (CBRTGS)

| <i>Subject</i> | <i>Main findings</i> |
|---|---|
| Well-founded basis in all relevant jurisdictions (CP1). | <p>The Central Bank of Barbados Act Sec 5 Purposes of the Central Bank, Section 39 provides the central bank with the right to organize a clearing house. Legal counsel advises that the establishment of an RTGS system is not inconsistent with the statutory purposes conferred on the central bank by the act. However, membership in such a system cannot be mandated by the central bank. Voluntary signing, by the participants, of the Terms and Conditions contractual document which describes all substantial matters relating to rights and obligations under which participants will access and use the RTGS system will provide a sound legal basis as per principle CP-1. The Electronic Transactions Act is also relevant as it provides legal validity to electronic transactions and electronic signatures. The Evidence Act has been amended to recognize such transaction and thus electronic records will be recognized in all judicial proceedings.</p> <p>This principle is broadly observed. It is critical that participants sign the Terms and Conditions documents prior to the RTGS system being operated with live transactions. Once this has been achieved, the principle will be observed. The envisaged meetings with individual CEO's of participating commercial banks to answer and resolve any final questions should be undertaken as a matter of urgency and should be used to request the signing of the Terms and Conditions contractual document.</p> |
| Clear understanding of the system's impact on risks and procedures for the management of risks (CPs 2 and 3). | <p>The Terms and Conditions of the RTGS sets out the roles & responsibilities of each participant. Participant procedures and user guides contain detailed information as to how transactions will be processed, queued, removed from queues, or rejected. Because of the nature of the gross settlement system, finality and irrevocability of payments are guaranteed. Participants will be able to avail of central bank overnight advances through the discount window. Although appropriate facilities are in place, consideration should be given to designing an emergency liquidity facility based on pre-agreements with participants for a central bank-invoked repo based on previously earmarked collateral.</p> <p>The Research, Bank Supervision, Banking, Accounts and Internal Audit staff all have appropriate needs-based levels of access to the system for monitoring purposes.</p> <p>The RTGS system acquired by the central bank of Barbados has a range of reporting and audit trail functionality that can be made available to participants on request to assist them in modeling their payments histories and thus proactively improve intra-day cash management. Observance of these principles is judged to be high.</p> |
| Prompt final settlement and multilateral netting (CPs 4 and 5). | <p>The RTGS system settles throughout the day on a real-time basis. No netting is involved, so principle 5 is not applicable.</p> |
| Assets for settlement (CP 6). | <p>Settlement is in central bank money. All participants are required to hold a reserve account at the central bank and funds are drawn on this account. The principle is observed.</p> |

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| <p>Security, operational reliability and contingency arrangements (CP7).</p> | <p>The RTGS has been set up to comply with the Central Bank Information Security Policy. A Virtual Private Network (VPN) gives participants' access to the RTGS. All participants will sign the VPN access policy document. The RTGS terms and conditions and operational and security procedures and arrangements are comprehensive, and proper contingency plans are in place to assure business continuity. The central bank has also established a hot back-up site where data is replicated and terminals have also been provided in case the prime site has to be evacuated. External security audits are done periodically, and contingency tests are planned quarterly. SWIFT is used for the payment leg of the transactions and those using it are subject to SWIFT contingency guidelines. The non- SWIFT banks will resort to fax, e-mail, and signed letters of instruction to the central bank. Gridlock resolution features are available in the system.</p> |
| <p>Practicality and efficiency (CP 8).</p> | <p>Most banks use SWIFT for foreign payments, and the same infrastructure has been utilized. The two small banks will use fax, e-mail and letters to authorize payments to other banks and the central bank. System costs have been minimized through a decision to use SWIFT only for submitting and receiving payment instructions. All other transactions such as account balance monitoring, queue management, and end of day reconciliation reporting will be undertaken via a browser-based system that makes use of the central bank VPN. Cost and technical efficiency has been carefully addressed.</p> <p>Item processing fees should be set to ensure that all transactions undertaken on behalf of the government are taken into account in the volume calculation to avoid any suggestions that commercial banks are subsidizing the accountant generals' transactions.</p> |
| <p>Objective and publicly disclosed criteria for participation (CP 9).</p> | <p>The Terms and Conditions of the RTGS and the Operations Circular clearly set out the access criteria. Banks that hold an account at the central bank; are regulated by the central bank and eligible to use the discount window can access the system. They must also subscribe to the VPN policy and accept responsibility for the security tokens assigned. The Accountant General is a special purpose member of the system. Transfer of responsibility from the central bank to the Accountant General for submitting government payments into the system will be undertaken on an already agreed phased basis. Participants will also be required to sign the necessary SWIFT Closed User Group forms.</p> <p>Some thought should be given to working with the participants - perhaps via the envisaged National Payments System Council (NPSC)—to promote a customer and wider community understanding of the RTGS system via the central bank website and through the workings of the envisaged NPSC.</p> |
| <p>Governance arrangements (CP10).</p> | <p>The Electronic Payments Committee of the central bank oversees its involvement in the RTGS system. The Director Banking & Currency has direct responsibility for the RTGS. The Governor holds quarterly meetings with the CEO's of the banks where payment system issues can be raised. The terms and conditions of the RTGS require internal and external audits by all participants and also provide for opportunities for participants to request changes.</p> <p>The establishment of the envisaged National Payment system Council should further improve the degree of accountability and transparency. Once the NPSC is established, this principle will be fully observed.</p> |

| Central Bank Responsibilities in applying the CPSIPS | |
|--|--|
| <p>Responsibility A – publicly disclosed policies of the central bank with respect to systemically important payment systems.</p> | <p>The Central Bank Act Sec 5 and Sec 39 refer to the purposes of the central bank and its role in setting up a Clearing House. The central bank is planning to issue a public document describing its role in the Barbados payment systems—“The Role of the Central Bank in the Payment System.” This document will be available in hard copy format and also available on the central bank website. These policies will also be clearly outlined in press conferences and operational Circulars.</p> |
| <p>Responsibility B – ensure that the systems operated comply with the core principles.</p> | <p>The business requirements for the system emphasized the need to comply with the BIS core principles. The central bank is also undertaking a self – assessment to ensure compliance with the core principles.</p> |
| <p>Responsibility C – The central bank should oversee observance with the core principles by systems it does not operate and it should have the ability to carry out this oversight.</p> | <p>Not applicable since the central bank owns and operates the RTGS.</p> |
| <p>Responsibility D – cooperation with other central banks and with any other relevant domestic or foreign authorities.</p> | <p>The central bank is a founding member of the Working Group on Payment Systems Issues of Latin America and the Caribbean. It is regularly represented at conferences and seminars on the Payment System and it also seeks to be cooperative with other central banks through, for example CEMLA activities and Caribbean regional activities including Committee of Central Bank Governors meetings and technical meetings such as those relating to the use of IT. The central bank should establish clear contact lines/agreements with other domestic and foreign regulators in order to ensure that the CBB and other authorities know what to do in the event of a default in the payment system in Barbados.</p> |

Recommended actions

Table 12. Recommended actions to improve observance of CPSS Core Principles and Central Bank Responsibilities in applying the CPs—CBRTGS

| <i>Reference principle</i> | <i>Recommended action</i> |
|--|---|
| Legal foundation CP 1 | Hold explanatory discussions with individual CEO's of each commercial bank to resolve any outstanding issues or misunderstandings. Use these meetings to request that they sign the Terms and Conditions contractual document. |
| Understanding and management of risks CPs 2-3 | Consider establishing a suitable emergency liquidity facility—possibly based on a central bank invoked repo—using previously earmarked government securities to avoid late in the day emergencies that cannot be addressed through inter-bank borrowing. |
| Efficiency and practicality of the system CPs 7-8 | Have participants sign the central bank VPN access agreement prior to implementation. Develop and implement a secure technical linkage between the respective VPN's in the central bank and the accountant general's department. When calculating item fees ensure that government transactions are taken into account and thus avoid any suggestions from commercial banks that they might be subsidizing government payments. |
| Governance of the payment system CP 10 | Establish the National Payments System Council, use it to enhance system governance, improve transparency and promote the use of electronic transactions by customers and by the wider community. |
| Responsibilities of the central bank in applying the CPs Responsibilities A--Public Disclosure | Finalize the "Role of the Central Bank in the Payment Systems" document as soon as is practicable and publish it in hard copy and on the central bank website. |

III. OBSERVANCE OF IOSCO PRINCIPLES OF SECURITIES SUPERVISION

A. General

108. This assessment covers the Barbados securities sector, for which regulation and supervision are largely the responsibility of the Securities and Exchange Commission (SC). The main objectives of the assessment are to determine levels of observance of the International Organization of Securities Commissions (IOSCO) principles and to suggest areas where further development may be appropriate. This assessment was undertaken as part of a Financial Sector Assessment Program (FSAP) for Barbados.

109. The assessment was conducted by Ms. Melinda Roth, Senior Financial Sector Specialist, Financial Sector Development Department of the World Bank. The assessment is based on the recently updated Barbadian IOSCO self-assessment as well as a review of the securities laws; internet sites and other documents; web sites and documents from the Barbados Stock Exchange (BSE) and information from the Barbados Central Securities Depository Inc. (BCSDI), and other publicly available information. Extensive discussions were held with the BSE/SC. In addition, meetings with market participants and other officials also provided input to the assessment.

110. The assessment is based on the Principles of Securities Regulation adopted by IOSCO in September 1998 and updated in February 2002 which contain detailed explanations in specific areas that should be observed under each principle. The assessment was based on the current status of the SC, recognizing that it is still in a transition phase and is not yet fully operational. This assessment notes which principles may be affected and should change when the transition ends.

B. Industry Background and Overview

Supervisory framework

111. The SC was established in 2001 through the implementation of the Securities Act (2001 – 13). Functions and responsibilities of the SC are defined in this Act which seems comprehensive and well drafted. Seven commissioners have been appointed by the Minister of Finance, including a Chairman. Staffing of the SC is not yet complete, as a CEO/General Manager and a legal advisor remain to be hired.

112. Before the new Securities Act, the securities market functioned without any independent regulatory oversight. The new Act separated the oversight functions from the Barbados Stock Exchange (BSE) attributing it to the SC. However, until the SC becomes fully operational, several regulatory powers have been delegated to the BSE, including monitoring the members of the BSE, regulation of daily trading, registration and licensing of market participants, approval of registrars and transfer agents for new securities and issuance of certificates of approval of prospectuses. Other powers have been delegated to the Barbados Central Securities Depository Inc (BCSDI), including regulation of clearing and settlement of transactions and approval of prospectuses in the case of new issues.

113. The independence of the regulator is important for market integrity, but will also help in the development of the capital markets. Given the resource constraints, removal of the regulatory functions from the BSE will help focus it more on issues related to the efficiency and development of the marketplace. In turn, the SC will be able to focus on market supervision, the protection of investors, and the promulgation of a clear regulatory structure which should also help the process of integration of markets within the Caribbean region.

Market structure

114. *Stock Exchange:* The original trading facility in Barbados was established in 1987, but in August 2001, the Barbados Stock Exchange was reincorporated according to the Securities Act. As of July 2001, the BSE has introduced electronic trading. Trading sessions occur twice a week. As of July 2002, there were 25 issues traded on the regular market, and 2 funds traded on the junior market.

115. *Market Infrastructure:* The Barbados Central Securities Depository Inc (BCSDI) is a wholly owned subsidiary of the BSE and is registered as a self-regulatory organization (SRO) under the Securities Act. BCSDI is responsible for clearing and settlement. Currently, the system uses a simple check settlement system, but with the introduction of a RTGS system a delivery versus payment (DVP) is to be adopted for securities transactions which could effectively eliminate any settlement risk in securities trading.

116. *Market Intermediaries:* There are 8 licensed brokers in Barbados as of July 2002. In addition there are 5 mutual fund asset companies (some of which manage more than one fund) with approximately BDS\$200 million under management.

117. *Debt Markets:* The trades on debt instruments are even less frequent than those on equities. Annual volume in 2001 for government securities in the secondary market, was BDS\$10 million. There are also two issues of corporate bonds, but both issuers are in the tourism sector and the bonds are guaranteed by the government.

C. Preconditions

118. Among the most critical preconditions for effective securities supervision are sound and sustainable macroeconomic policies conducive to investment and savings, enforceable property rights, a supportive political environment free from corruption, well developed infrastructure (such as legal and accounting practices, clearing and settlement systems, payments system) and an effective judicial system. Corporate governance and insolvency mechanisms are also necessary. These appear to be largely in place in Barbados in the form of enacted laws and institutions, although the implementation of the laws and the effectiveness of institutions have yielded mixed results.

119. IOSCO also lists several attributes necessary for effective regulation: no unnecessary barriers to entry and exit from markets and products; market openness to the widest range of participants which meet predefined entry criteria; regulator's awareness of the impact of new policies. These preconditions appear to be met in Barbados.

D. Main Findings

120. Most of the principles have been “implemented” or “partially implemented,” with only two principles determined to be “not implemented.” The SC has the potential to act as a strong regulator with comprehensive powers, and it has the willingness to carry out its supervisory mandate. In fact, the legal framework (mainly the Securities Act) is excellent as it is thorough, including broad powers for the SC, immunity of staff discharging their duties in good faith, strict confidentiality and conflict of interest clauses for commission members and SC staff, definitions and penalties for improper market behavior and strong disclosure requirements for issuers.

121. However, the SC is not yet fully staffed nor fully operational. In addition, the regulations pursuant to the Securities Act need to be passed as does the new Mutual Funds Act and its accompanying regulations. The passage of this legislation will improve the IOSCO assessment.

122. The remaining priorities facing the SC are in the areas of enforcement and ensuring compliance. While the Securities Act provides the proper tools for the SC, such mechanisms have not been used in the market as no third party oversight existed previously. The SC needs to be staffed adequately to supervise efficiently all market participants and mutual funds. Licensing and submission of annual reports are insufficient to ensure protection of investors and proper functioning of the market. Inspections, investigations and enforcement actions are required.

Other suggested areas of improvement include the following:

- increased disclosure including immediate or as soon as practical disclosure of legal insider buying and selling;
- risk based prudential requirements should be implemented for licensed market intermediaries; and
- securities clearing and settlement should move toward DVP principles and T + 3 settlement cycle.

123. A summary of the main findings of the assessment of observance to IOSCO Principles is as follows:

Table 13. Summary of Main Findings for Securities Supervision Principles

| Subject | Main Findings |
|---|---|
| Principles relating to the Regulator (1–5). | The SC has broad powers. It is independent and accountable, but relies on the Minister of Finance for financing and for promulgation of regulations. Accompanying regulations to the Securities Act should be passed soon. |
| Principles of self-regulation (6–7). | The BSE and BSCDI are registered as SROs. The SC should treat them as market participants and inspect them regularly. In addition, the SC may contemplate submission of the minutes from the SROs' meetings of Board of Directors. |
| Principles for the enforcement of securities regulation (8–10). | While the legal framework provides the SC with sufficient inspection, investigation and surveillance powers, these powers have not yet been extensively utilized so far. |
| Principles for cooperation in regulation (11–13). | Domestic and foreign coordination requires improvement and potentially more formal arrangements for information sharing. |
| Principles for issuers (14–16). | Disclosure could be improved by providing for immediate disclosure of any legal insider buying or selling in a listed company. The Securities Act provides for greater disclosure, including that any public company must register with the SC, but these practices are not yet fully implemented by companies. |
| Principles for collective investment Schemes (17–20). | The new Mutual Funds Act needs to be passed, along with the accompanying regulations. |
| Principles for market intermediaries (21–24). | The securities laws provide minimum requirements for intermediaries (whether banks or not). Inspections, regular reporting of prudential guidelines, and risk based prudential requirements are needed. |
| Principles for the secondary market (25–30). | Clearing and settlement should move to the DVP basis when the new RTGS system becomes operational. The contingency fund should be implemented. |

E. Recommended Action Plan and Next Steps

Recommended actions

A recommended action plan to improve the implementation of the IOSCO objectives and principles is presented below:

Table 14. Recommended Plan of Actions to Improve Implementation of the IOSCO Objectives and Principles of Securities Regulation

| Reference Principle | Recommended Action |
|---|--|
| Principles Relating to the Regulator (CP 1–5) | Continued investor education and public information is needed. Integration of government budget resources with fee based revenues. |
| Principles of Self-Regulation (CP 6–7) | Submission by the BSE and BCSDI to the SC of the minutes of any Board meetings |
| Principles for the Enforcement of Securities Regulation (CP 8–10) | Implementation of enforcement through use of the powers allowed in the Securities Act. |

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|---|--|
| Principles for Cooperation in Regulation (CP 11-13) | Improved and regular cooperation with financial sector regulators, including potential joint inspections of conglomerates. More formal meetings and/or arrangements with relevant regional counterparts. |
| Principles for Issuers (CP 14-16) | Disclosure could be improved through (i) providing for immediate disclosure of any legal insider buying or selling in a listed company; and (ii) providing for immediate disclosure of material events, including the acquisition of 5 percent of a listed company. |
| Principles for Collective Investment Schemes (CP 17-20) | Passage of the new Mutual Funds Act and accompanying regulations needed. |
| Principles for Market Intermediaries (CP 21-24) | Risk based liquid asset requirements needed. Large exposures and other prudential guidelines need to be implemented. |
| Principles for the Secondary Market (CP 25-30) | Clearing and settlement needs to move to a DVP basis. Standards for margin lending and proprietary trading for brokers should be implemented. Put-through transactions should be formally eliminated. Paper share certificates should be eliminated for future new issues and only dematerialized issues allowed. |
| | |

Authorities' Response

Principles relating to the Regulator – Ps1-5: The Securities Commission has communicated the importance of the enactment of this legislation and is satisfied that the matter is being addressed by the Chief Parliamentary Counsel. It is anticipated that it would be enacted before December 31, 2002.

Principles of Self-Regulation – Ps6-7: The Securities Commission is cognizant of its legal responsibility to regulate SROs. The BSE and BCSDI are also aware that they are under the regulatory responsibility of the SC. As soon as this Report is finalized, the Boards of the BSE & BCSDI will be made aware of the requirement to submit Board Minutes to the SC.

Principles for the enforcement of securities regulation 8-10: Inspection, investigation and surveillance are priority areas for implementation as soon as the Commission is fully staffed and operational.

Principles for co-operation in regulation 11-13: The Commission has started its research in this area. The approach is to ascertain whether it is necessary to obtain another formal arrangement for sharing information on Securities business if there is already a Country to country bilateral arrangement in place. If the answer is no, the Commission would acquire

the list of countries with whom Barbados already has such an Agreement and treat requests for countries which do not have the arrangement on a case by case basis, obtaining the final approval from the Minister, to share the information.

Principles for Issuers Ps 14-16: Work has already started in this area beginning with the Mutual Funds. Timeframes for reporting are written into the Act with a maximum of 7 days to report or the Commission could impose a fine.

Principles for Collective Investment Schemes – Ps17-20: The Bill and Regulations are ready for approval as soon as Parliament resumes from Summer recess, October 1, 2002.

Principles for market intermediaries, Ps21-24: Prudential guidelines as well as risk based prudential requirements are being considered beginning with the Broker-Members of the BSE.

Principles for the Secondary Market – Ps25-30: CBB plans to 'go live' with RTGS on October 1, 2002. Within two weeks after that date, BSE & BCSDI plan to follow suit with remote trading and simultaneous computerized clearance and settlement since the electronic system is tightly coupled.

IV. ASSESSMENT OF OBSERVANCE OF THE IAIS INSURANCE CORE PRINCIPLES

A. General Background and Overview

124. The assessment of the Insurance Sector in Barbados was performed as part of the joint IMF-World Bank Financial Sector Assessment Program. The main objectives of the assessment are to determine the levels of observance with the International Association of Insurance Supervisors (IAIS) principles, and to suggest areas where further development may be appropriate. The assessment covers both on-shore and off-shore insurance sectors and has been undertaken by Mr. Craig Thorburn, Senior Financial Sector Specialist, Financial Sector Department of the World Bank.

Information and methodology used for assessment

125. The assessment is based on a review of the self assessment prepared by the Supervisor of Insurance in comparison with the International Association of Insurance Supervisors (IAIS) Core Principles and Core Principles Methodology; review of the insurance laws in Barbados--including the *Insurance Act 1996*, which regulates on-shore companies, and the *Exempt Insurance Act*, which regulates off-shore insurance operations; and discussions with the Supervisor of Insurance, several insurers, ratings agencies and auditors.

B. Institutional Setting and Market Structure

126. The private insurance sector in Barbados is taken to cover non life insurance (referred to as general insurance) and life insurance. In 2000, Swiss Re Sigma 6/2001 reported that the insurance market in Barbados had total premiums of US\$184 million. The market is small in world and regional terms, ranking 79th in the world, compared with: Trinidad and Tobago, US\$424 million, ranked 57th; the Bahamas, US\$321 million, ranked 65th; and Jamaica US\$303 million, ranked 66th. Premiums per capita are high at US\$692 ranked 28th in the world and second only to the Bahamas in the region US\$1070 ranked 21st. Premiums as a percentage of GDP for Barbados, commonly referred to as “insurance penetration,” stood at 7.4 percent, ranking the country 16th on this measure.

127. The domestic market is stable and is reported to be profitable. The relatively small population combined with the levels of insurance and numbers of distributors suggests that companies have little prospect of benefiting from organic growth in the domestic market and, as a result, are focusing on increasing the product lines to their customer base and achieving economies through acquisition. We are advised that there are 19 companies operating in the domestic market of which 9 are life insurers and 10 are non life insurers. Four of the 19 companies are branch operations.

Non Life (General) Insurance

128. The domestic non life insurance market is dominated by the motor insurance class which represents by far the largest product line in the market. Motor insurance includes both

third party liability insurance as well as property damage type covers. This line of business covers two-thirds of the total net premiums in the general insurance sector.

129. Accident and sickness insurance has been consistently the second largest class at around 12 percent of the total net premium.

130. For property insurance, the third largest class at around 10 percent of net premiums, cessions to reinsurers are high at between 85 percent and 90 percent of premiums for the industry as a whole. In part, the reason for this is the significant reinsurance needs and costs associated with the catastrophe risk exposures in Barbados, although it is noted that insurers have not made material claims for hurricanes for several decades.

131. The Insurance Corporation of Barbados is large and is still majority owned by the state. The company has been partially privatized and it is intended to further reduce the level of public ownership in the future.

Life Insurance

132. The Barbadian domestic life insurance market represents BDS\$116 million of premiums, most significantly represented by individual life insurance products. In addition, annuity business is a growing market reflecting increased interest in retirement planning. The other class, group life insurance, is fairly mature. Reinsurance cessions in life insurance are low.

133. There are over 80,000 policies in force; a high number compared to the size of the population. Total levels of insurance, measured by sums insured, exceed BDS\$5,000 millions suggesting that sums insured per capita are also high relative to average earnings.

134. The largest companies, the Barbados Mutual Life Assurance Society (the Mutual) and the Life of Barbados Limited (LOB), have been undergoing change. LOB was the subject of an active takeover which involved a competitive bidding duel between the Mutual and a non-Barbadian company which was eventually resolved in favor of the Mutual. This leaves the Mutual's combined operations as dominant in the market with an estimated market share in excess of two-thirds of the domestic life insurance market. The company is undergoing a process of demutualization and listing. The share of the company's business represented by the domestic sector is less than 1/5th.

Off Shore Sector

135. There are around 180 active off shore companies. The vast majority of these are of USA and Canadian origin. These companies report as having premium income of around BDS\$10 billions before reinsurance and BDS\$5 billions net of reinsurance. Assets exceed BDS\$30 billions against liabilities of BDS\$25 billions. Assets and liabilities are materially and in many cases entirely off shore.

C. General Preconditions for Effective Insurance Supervision

136. The supervision of insurance, both the local market and the off shore sector, falls under the Minister of Finance and is officially performed by the Supervisor of Insurance. This authority is granted for the domestic market under section 4(1) of the *Insurance Act 1996* and for the off shore market under various sections of the *Exempt Insurance Act of 1983*. The domestic legislation represented an update of previous legislation, the Insurance Act of 1972, illustrating a longer history of industry regulation.

137. The definition of companies under the *Insurance Act* distinguishes between foreign companies and others in such a way that the corporate law applying is the general corporate law of the home country. Foreign companies are defined to be those outside the Caribbean Community and CARICOM Market. There is a dependency on the corporate laws both within the domestic market, the CARICOM market, and outside the CARICOM.

138. It is considered that the judicial system does not present any concerns for the effective operation of the insurance regulation and supervisory requirements. There is a small but well qualified actuarial profession in the country, and considerably larger in number than most countries of similar size. Transparency is subject to a separate assessment so is not subject to comment here.

D. Main Findings

Table 15. Main Findings of the Assessment of Observance of the IAIS Insurance Supervisory Principles

| Subject | Main findings |
|---|---|
| <p>Organization of an Insurance Supervisor (CP 1)</p> | <p>The office of the Supervisor of Insurance is part of the Ministry of Finance and is established under the Insurance Act through section 4(1). The office is legally subject to the ministerial responsibility and direction of the Minister of Finance. Beyond the general understanding that the Supervisor is responsible for the administration of the Act no mission or mandate had been developed. Funding is secured through the annual budget process and there is no practice of carry over of underspends at the end of each year.</p> <p>The supervisor and the staff are subject to the generally applying ethical guidelines for the public sector, have specific confidentiality requirements in the insurance law, and are recruited and remunerated under the general public sector rules. Staff turnover has been low. Ethical requirements are robust. The supervisor is able to, and does, require companies to obtain additional technical support for the supervisor on particularly complex matters. Transparency of the supervisory process relies on the fact that the supervisor maintains contact with companies and that the legislation is readily available and descriptive. An annual report is required to be produced by the supervisor for the domestic sector and the current report, is in the process of being prepared and tabled before the parliament. Staffing is not adequate, resources are subject to the general budget processes as part of the ministry of finance.</p> <p>With respect to the off-shore market, the legislation makes it clear throughout the act that the Supervisor of Insurance is the responsible authority. There is no requirement for an annual report under this act although the draft report we have seen for the domestic sector also</p> |

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| | <p>provides some information on the off shore sector. Although the overall assessment is that this principle is materially not observed, improved resources and transparency should substantially improve the assessment.</p> |
| <p>Licensing and changes in control (CPs 2-3)</p> | <p>Under Section 6 of the Insurance Act, the Supervisor maintains a register of insurers carrying out comprehensively defined classes of insurance business. Section 7 of the Insurance Act requires only bodies corporate to carry on insurance business. Section 8 indicates that the Supervisor must be satisfied that the articles of the body corporate restrict its activities to insurance, that it has to be registered under the Insurance Act, that it has made a required deposit (Section 23 of the Act) and that, for foreign companies, there are authorized resident persons identified in Barbados for the purpose of serving documents in any legal proceedings.</p> <p>Under Section 11 there is a prescribed form for applications and a prescribed fee and there is the power to require additional information relevant in relation to the application. Fitness and propriety tests under the insurance act sub-section 12(f) refer to the Managing Director, CEO or principal representative of a company only. Section 12(g) requires a business plan. The prescribed form elaborates this requirement to the effect that a two year financial projection is provided in a high level summary form.</p> <p>The power to consult with other jurisdictions as part of the license process exists and is used. Section 9(1) of the Insurance Act imposes a minimum amount of capital for companies on application. There is a statutory fund requirement for long term insurance and motor vehicle insurance.</p> <p>It is possible to register a company with conditions. A refusal to register a company by the supervisor provides a company with the right to have the proposed refusal reviewed by the Minister.</p> <p>Similar provisions exist in the Exempt Insurance Act with the exception that the information provided, particularly with respect to business plans, are less comprehensive. Enhancement of these procedures would assist in full compliance.</p> <p>Section 14 of the insurance act requires notification within 30 days of any changes that take place in the license application information, including ownership structure and control. The insurance supervisor has the power to intervene should information provided under section 14 be of concern. For exempt companies, the situation is clearer, transfer of shares are subject to regulatory approval.</p> <p>Compliance with these principles and the essential criteria is strong. Whilst there are some areas where there is scope for elaboration, this is not priority issue. The uncertainty that currently exists on the transfer of shares could be clarified and would be useful to ensure that the requirements of Section 14 are well understood by companies.</p> |
| <p>Corporate governance and internal control (CPs 4-5)</p> | <p>The general corporate law requires that company bylaws are filed with the corporate authorities. It is considered by the authorities that the requirements for corporate governance should be included in these bylaws. The supervisor has general authority under the Insurance Act to address corporate governance requirements for insurers through, for example, powers to place conditions on licenses, powers to give directions to companies, the ability to issue circulars setting out expected good practice or other means. In all of these cases, these requirements if set out would have considerable force and be capable of direct enforcement. No such standards have, however, been issued at this point.</p> <p>Under the Exempt Insurance Act, the requirements for corporate governance are set out more specifically and also include a series of specific requirements and obligations that require approval.</p> |

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| | <p>Section 50 of the Insurance Act provides the supervisor with general powers to obtain information. The insurance supervisor has the authority to require companies to provide suitable prudential oversight, including monitoring controls for underwriting risks, valuation of policy liabilities, investment and reinsurance, dealing with monies, and agent and broker requirements. Several parts of the law address issues such as contractual limitations and the treatment of customers. Internal risk management procedures are not explicit in all cases, however, and the requirements to report to boards on matters such as the use of internal audit, segregation of duties, or cross checking are not given particular reference in the law. Safekeeping of assets, with respect to life insurance and motor insurance, are enhanced through a legal requirement for a separate fund arrangement. As such, the supervisor has general authority to address internal control requirements for insurers supplemented by some specific requirements in the law. Enforcement of requirements relies on general surveillance only as formal reporting does not address these matters and inspections have not been able to be carried out fully as yet due to the resource constraints. No such circulars or elaboration of requirements have, however, been issued at this point.</p> <p>For the offshore companies, there are some more detailed requirements and there is the additional procedure of approved management companies. As a result, the assessment for off shore companies is better than for the domestic market.</p> <p>For domestic companies, these principles are materially not observed, but are largely observed for off shore companies. Substantially, this assessment reflects the requirement that the powers exist and are used. The existence of the powers is adequate, but the absence of several requirements that could be expected to be in supervisory circulars or more detailed elaboration of requirements, and the absence of evidence that such requirements are enforced leads to the current assessment.</p> |
| Prudential Rules (CPs 6-10) | <p>Assets which are to qualify to support the regulatory requirements are identified and subject to limitation in the insurance act. These rules have the effect of restricting investment in assets where the risk would be particularly high. There is a considerable responsibility on the auditor to carry out many of the responsibilities required for effective supervision and to assess the adequacy of the risk management and asset security arrangements for the company. On site inspections by the supervisor in this area are proposed.</p> <p>The actuary certifies that the value of the assets is "not less than" is shown in the balance sheet "to the best of their knowledge and belief." Section 24(4) of the Exempt Insurance Act deals with asset requirements of similar scope to the domestic market. Principle 6 is judged to be largely observed, although, there is scope for enhancement of the requirements for assets. A general circular on the treatment of assets is suggested.</p> <p>For the domestic market, capital requirements for fixed dollar minimum levels are prescribed and enforced. For general insurance there is a capital requirement relating to premiums set out in sub section 58(1) (b) of the insurance act. There is provision in the Act for a requirement for life insurance (subsection 58(1)(a)) which has yet to be developed although larger companies have a practice in place following the Canadian model. There is no specific attention in the Insurance Act to the appropriate form of capital instruments although the supervisor would have the capacity to provide guidance for this aspect if it was felt necessary. Double gearing of capital is not addressed in the regulatory structure and there are cases where it exists in the current market.</p> <p>The supervisor has the legal capacity to enforce a more robust capital regime including the establishment of control levels, requirements to hold higher capital levels, and other requirements through general provisions but the combined effects of limited resources and the absence of explicit coverage of several components of the solvency margin regime in the legislation leaves this capacity largely unexploited.</p> |

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| | <p>For the off shore regime, section 24 of the Exempt Insurance Act has the effect of applying a solvency requirement for general insurance but not for life insurance. There is a need to formalize a life insurance requirement to bring the jurisdiction into full compliance with the core principle. Capital control levels and structures could be introduced through circulars and other mechanisms after a review and modernization of methods.</p> <p>Derivative use on the domestic market is understood not to be relevant. There are no current requirements or guidelines in place but the Insurance Act would provide the supervisor with the power to issue such guidelines when necessary and to intervene on inappropriate or inadequate practices within companies.</p> <p>For the off shore market, it is considered likely that companies would have derivative exposures and off shore assets managed utilizing off balance sheet contracts. There are no requirements in place for either control or reporting of these contracts. Thus, principle 9 is not applicable for domestic companies and not observed for offshore companies. For the off shore market, there is a more immediate need to address asset rules including rules for the treatment of off balance sheet items.</p> <p>For domestic companies, reinsurance arrangements are reviewed continually both through supervisory practices and also as a natural consequence of the requirements to approve premium payments under foreign exchange laws. Attention is given to both the levels and appropriateness of cover as well as the quality of the counterparty. Intervention by the supervisor can be evidenced in support of these objectives.</p> <p>For exempt companies, there is provision to review reinsurance arrangements as part of the license process and for ongoing supervision although the mechanism for doing so is not as strong as for domestic companies. The regulatory support for this activity is more general rather than specific and there is no guidance as to what the supervisor may find as acceptable nor is there a clear statement of the need to report changes in the reinsurance arrangements. Thus, principle 10 is largely observed. It is recommended that requirements for reinsurance be developed and promulgated, particularly for off shore companies where the more exotic reinsurance applications are likely to be considered. The large number of off shore companies makes this more necessary given that supervisory resources are limited and detailed on site inspections, even when fully instituted, are less likely to fully compensate for the silence of the law in this area.</p> |
| <p>Principle 11. Market Conduct</p> | <p>Under the Insurance Act, all distributors are licensed annually and this process includes fitness and propriety tests covering both ethical standing and training obligations. Section 5 provides that the Supervisor of Insurance acts as arbitrator in disputes between an insurer and a policy-holder. The supervisor has the authority to have disputes resolved through direction and has the legal power to investigate cases, and market conduct more generally through on site inspection. We are advised that product disclosures are subject to case by case approval by the supervisor, and under section 80(3) it is possible to prevent unauthorized intermediaries from conducting business.</p> |
| <p>Principle 12. Financial Reporting</p> | <p>Sections 39 and 40 of the Insurance Act provides for annual returns to the supervisor and by public disclosure on a solo and consolidated basis. The insurance supervisor has the scope and authority to require additional reports on a more frequent basis and covering any aspect of the companies operations, either individually or for the whole market. The supervisor can reject the returns, or require them to be amended. Accounting practices could be established by the supervisor, but the current practice is to rely on the use of internationally accepted accounting practices. Minimum values for unexpired premium provisions are stipulated in section 149 of the insurance act. Verification by the auditor is required. A program of off site inspections is under development. Section 18 of the Exempt Insurance Act has a similar effect for the off shore market.</p> |

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| | <p>There are only two shortcomings against the criteria for this principle. First, the absence of on site inspections requires additional resources and a program to be put in place and will be addressed elsewhere. Second, the level of detail in the reports provided suggests that only limited analysis can be done by the supervisor arising from these returns in any event.</p> |
| <p>Principle 13. Onsite Inspection</p> | <p>Under both the Insurance Act and the Exempt Insurance Act, the insurance supervisor has the legal authority to conduct on site inspections and gather whatever information is deemed necessary, whether this be general in nature on specific issues. In practice, however, limited resources have meant that a program of inspections is not yet implemented. A small number of inspections have recently been initiated for off shore companies.</p> <p>The principle is judged to be materially not observed. The supervisor will need additional resources to implement a program of inspections. To support this initiative, financial reporting and off site analysis should also be enhanced so that the on site inspections can be conducted effectively and efficiently.</p> |
| <p>Principle 14. Sanctions</p> | <p>Grounds for cancellation of registration are set out in section 15(2) of the Insurance Act and section 12 of the Exempt Insurance Act. Other sanctions include directions, restrictions on ability to write business, and other conditions on licenses. Applications for licenses can be refused. There is provision, in some cases, for fines and imprisonment under the insurance act.</p> |
| <p>Principles 15-17 Cross-Border Business Operations, Coordination and Cooperation, and Confidentiality</p> | <p>There are a number of companies with operations or connections in other jurisdictions which are licensed as domestic insurers in Barbados. In addition, the off shore market is, by definition, connected to other jurisdictions. Communication with other supervisors in the Caribbean region is of great importance as this is the main source of linkage in the domestic market. Legal powers to exchange information are not specifically included in Insurance Act. The supervisor has been proactive in this regard. The Exempt Insurance Act section 35, however, provides for legal exchange of information – which is used routinely.</p> <p>The Supervisor has been proactive with respect to communication with other supervisors. It would be necessary, for full observance, to include a confidentiality clause similar to that of Section 35 of the Exempt Insurance Act in the Insurance Act.</p> <p>There are a small number of banks owned by insurance companies in Barbados. Informal collaboration is in place and quarterly meetings of supervisors are conducted although these are reported as rarely involving the discussion of particular institutions. The insurance supervisor considers that he has the power and capacity to respond to requests for information from other supervisors inside and outside the jurisdiction. The requirements in the Exempt Insurance Act, particularly Section 35 means that observance of the principle for this sector is stronger.</p> <p>Recent events in Barbados, where the life insurance companies were subject to change of ownership, were not the subject of inquiry from the banking supervisors. As a result, it is suggested that domestic supervisors may wish to develop more formal protocols for exchange of information. It is also necessary to consider the introduction of some aspects of conglomerate supervision, possibly identifying a lead regulator and defining appropriate rules to address double counting of capital and the enforcement of proper risk management standards for groups especially concerning intra-group transactions.</p> <p>The secrecy constraints that apply to the supervisor are set out in the general public sector rules with respect to the domestic market and Section 35 of the Exempt Insurance Act. Sharing of information is permitted for prudential reasons under these requirements. The requirements are sound.</p> |

The observance of these principles is therefore generally high and stronger in the offshore companies.

E. Recommended Action Plan and Authorities' Response to the Assessment

Recommended action plan

Table 16. Recommended Action Plan to Improve Observance of IAIS Insurance Core Principles

| Reference Principle | Recommended Action |
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| Organization of an Insurance Supervisor (CP 1) | Several aspects of the operation and standing of the supervisor's office could be reviewed and adjusted including resources, funding methods and transparency which, have the potential to be introduced with limited addition to fiscal cost or adjustment to the existing laws but would improve the compliance with this principle and ensure that the risk of reputational damage to the important offshore sector is limited. |
| Licensing and Changes in Control (CPs 2-3) | The current uncertainty surrounding the transfer of ownership through share transfer in the Insurance Act should be clarified to ensure that full compliance with the change of control principle is maintained. Reinforcing the implied requirement for all companies to provide advice to the supervisory authority regarding changes to information provided at registration would also be useful. |
| Corporate Governance and Internal Controls (CPs 4-5) | The development of specific requirements and their implementation and enforcement is necessary to raise compliance with these two principles, noting that the current legislation appears to provide sufficient powers to permit this course of action to be taken by the supervisor. |
| Prudential Rules (CPs 6-10) | <p>A general circular on the treatment of assets may be useful. More importantly, the implementation of off site and on site inspections of provisioning is necessary.</p> <p>There is a need to formalize a life insurance solvency margin requirement to bring the jurisdiction into full compliance with the core principle. Capital control levels and structures could be introduced through circulars and other mechanisms after a review and modernization of methods.</p> <p>For the off shore market, there is a more immediate need to address asset rules including rules for the treatment of off balance sheet items.</p> <p>Requirements for reinsurance should be developed and promulgated, particularly for off shore companies.</p> |
| Market Conduct (CP 11) | The level of transparency in complaints processes could be enhanced through increased requirements for publication of the existence of policyholders' rights for resolution. |

| Reference Principle | Recommended Action |
|---|--|
| Monitoring, Inspection, and Sanctions (CPs 12–14) | The supervisor will need additional resources to implement a program of inspections. To support this initiative, financial reporting and off site analysis should also be enhanced so that the on site inspections can be conducted effectively and efficiently. |
| Cross-Border Operations, Supervisory Coordination and Cooperation, and Confidentiality (CPs 15–17) | <p>The Supervisor has been proactive with respect to communication with other supervisors. It would be necessary, for full observance, to include a confidentiality clause similar to that of section 35 of the Exempt Insurance Act in the Insurance Act.</p> <p>Recent events in Barbados, where the life insurance companies were subject to change of ownership, were not the subject of inquiry from other supervisors in the region or within Barbados. As a result, it is suggested that supervisors in the region may wish to develop more formal protocols for exchange of information. It is also important to define criteria for the supervision of financial conglomerates.</p> |

Authorities' response to the assessment

139. The authorities are generally in agreement with the assessment and recognize that there are areas that can be improved by instituting internal codes of conduct for the industry; others would require more research and a more formal approach to become compliant. It is also recognized that additional resources are required but it should be noted that arrangements have been made with the Ministry of Finance in this regard.

140. It is expected that these matters would be addressed systematically going forward.

V. OBSERVANCE OF THE IMF'S CODE OF GOOD PRACTICES ON TRANSPARENCY IN MONETARY AND FINANCIAL POLICIES

A. Monetary Policy

General

141. The assessment of the observance by the Central Bank of Barbados of the IMF's *Code of Good Practices on Transparency in Monetary and Financial Policies* (MFP Transparency Code) for monetary policy was conducted as part of the joint IMF-World Bank Financial Sector Assessment Program (FSAP) mission to Barbados that took place in June-July 2002. The assessment was based on (i) a review of relevant laws and regulations, (ii) information available on the CBB web site and in a variety of official CBB publications, and (iii) discussions with the CBB, the Ministry of Finance, and market participants. The assessment has taken into account the implementation issues mentioned in the *Supporting Document* to the MFP Transparency Code.¹⁸

142. The Barbadian authorities cooperated fully with the assessment and provided all of the necessary information and documentation requested by the mission.

Main findings

143. Monetary policy in Barbados is conducted by the Central Bank of Barbados (CBB). Since 1975, Barbados has maintained an exchange rate targeting framework of its monetary policy, with the Barbados dollar pegged to the U.S. dollar at BDS\$2 = US\$1. The record indicates that the exchange rate peg has served well as a nominal anchor, and Barbados has preserved price stability and steady real effective exchange rate.

Clarity of roles, responsibilities, and objectives of the CBB for monetary policy

144. Objectives of monetary policy, institutional framework, relations between monetary and fiscal operations, and agency roles performed by the CBB are clearly defined in laws and regulations, including the Central Bank of Barbados Act (CBB Act). There are, however, several areas in which transparency could be further enhanced. The authorities could consider: (i) to publicly disclose the institutional responsibilities for the choice of exchange rate regime; (ii) to publicly clarify whether loans from the CBB to the government under the Special Loans Act are included in the limit on CBB temporary advances to the government; (iii) to disclose the interest rate charged on the CBB credits to the government and that paid on the deposits of the government with the CBB; (iv) to disclose the extent of the CBB's involvement in the rest of the economy; and (v) to disclose the CBB's responsibilities in the management of domestic and external public debt.

¹⁸ The assessment was undertaken by Vassili Prokopenko (IMF).

Open process for formulating and reporting of monetary policy decisions

145. An open process for formulating and reporting monetary policy decisions is fully observed. The CBB Act establishes the basic instruments and methods of monetary policy. Policy changes are promptly communicated and explained in the CBB’s press releases, the monthly *Economics and Financial Statistics*, and the *Annual Report*. Fundamental changes are in practice—but not in law—precede by consultations with the parties concerned. However, there is a tendency to limit the communication of policy measures to affected parties, instead of to the public at large. In this regard, a more active dissemination of the information through the CBB’s web site could substantially improve outreach.

Public availability of information on monetary policy

146. Transparency practices are fully observed in the area of public availability of information on monetary policy. Barbados participates in the IMF’s General Data Dissemination System. Presentations and releases of the CBB data meet the GDDS standards related to periodicity and timeliness of data and broadly meet the GDDS standards related to coverage of data. The CBB has a broad range of publications, and it maintains close contacts with media representatives. Governor of the CBB holds quarterly conferences and gives occasionally interviews and public speeches. The CBB also maintains a web site, and the texts of regulations issued by the CBB are available to the public free of charge.

Accountability and assurances of integrity by the CBB

147. Following the legislative requirements, the CBB publicly discloses audited financial statements of its operations in the *Annual Report*. The CBB staff is subject to specific standards of conduct, and the CBB has internal governance procedures to ensure the integrity of its operations. To enhance the transparency of the CBB’s operations, a consideration could be given to disclose more information on the existing internal mechanisms to control the CBB’s activities as well as to disclose the outcome of internal audit reports and the corrective actions taken.

148. Table 17 briefly summarizes the main recommendations based on the assessment of MFP Transparency Code for monetary policy.

Table 17. Recommended Plan of Actions to Improve Observance of IMF’s MFP Transparency Code Practices—Monetary Policy

| Reference Practice | Recommended Action |
|---|---|
| I. Clarity of Roles, Responsibilities and Objectives of Central Banks for Monetary Policy | It is recommended that the CBB and the Ministry of Finance publicly disclose which institution is responsible for the choice of exchange rate regime. |
| | It is recommended to publicly clarify whether loans from the CBB to the government under the Special Loans Act are included in the limit on CBB temporary advances to the government. |

| Reference Practice | Recommended Action |
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| | The CBB could consider disclosing the interest rate charged on its advances to the government and that paid on the deposits of the government with the CBB. |
| | The procedures for the CBB's involvement in the rest of the economy could include provisions for public disclosure of the extent of the CBB's involvement. |
| | It is recommended to disclose the CBB's responsibilities in the management of domestic and external public debt. |
| II. Open Process for Formulating and Reporting Monetary Policy Decisions | The CBB could commit itself publicly to a presumption in favor of public consultations, within an appropriate period, for substantive technical changes to the structure of monetary regulations. |
| III. Public Availability of Information on Monetary Policy | No action required. |
| IV. Accountability and Assurances of Integrity by the Central Bank | The CBB could consider to disclose more information on the existing internal mechanisms to control its activities as well as to disclose the outcome of internal audit reports and the corrective actions taken. |

Authorities' response

149. The CBB reviewed the draft assessment and provided additional clarifying information, which was incorporated into the final assessment. Overall, the authorities were broadly in agreement with the assessment. They stressed, however, that the assessment of transparency practices should take into consideration individual country circumstances. This was particularly important for small island economies, where because of the small number of institutions and population, as well as personal and institutional interconnectedness, a literal application of the transparency code could be problematic.

B. Banking Supervision

General

150. This assessment reviews the extent to which the IMF's Code of Good Practice on Transparency in Monetary and Financial Policies pertaining to Banking Supervision is followed by the authorities in Barbados. It was carried out in the context of the FSAP for Barbados during June 24 to July 4, 2002 by Mr. C. C. Procter, a Consultant to the IMF with relevant experience with the Reserve Bank of Australia in collaboration with Mr. Keith Bell (formerly of OFSI Canada), a Consultant who assessed compliance with the Basel Core Principles of Effective Banking Supervision.

151. Discussions were held with the Director, and key staff, of the Department of Bank Supervision in the Central Bank of Barbados (CBB). Consultations were also held with commercial banks (both domestic and foreign), external auditing firms, and a commercial law firm. Extensive use was made of the three Self-Assessment Questionnaires prepared by the authorities covering

- the Basle Core Principles for both the Onshore and Offshore sectors, and

- the IMF's MFP Transparency Code.

The document 'Reform of the Supervision and Regulation of Financial Institutions – Barbados' prepared for the Ministry of Finance in 1997, provided some useful background.

152. The core pieces of Legislation are the Central Bank of Barbados Act, the International Financial Services Act 2002,¹⁹ and the Financial Institutions Act 1996.

153. There are currently 57 banks in the offshore banking sector. Total assets are about 9 times those of the domestic banking industry. Offshore banks provide international financial services, and in general are not involved in retail business, or business in Barbadian dollars. Hence a number of issues that may be significant for transparency in the domestic market do not apply to, or are less significant for, international banks. This assessment accordingly focuses on the domestic market, with specific reference to the offshore market where appropriate.

154. The CBB is responsible for the regulation and supervision of the banking sector, both domestic and offshore, under mandate from the Minister of Finance. The broad objectives and institutional framework of the Bank in this area are set out in the legislation viz. the Central Bank of Barbados (CBB) Act; the Financial Institutions Act 1996 (FIA); the International Financial Services Act 2002 (IFSA); and Regulations made under the FIA.

Main Findings

155. Given the relative size of the banking sector, the CBB has a predominant regulatory role. A significant requirement, in filling that role, is the degree of transparency of the regulatory requirements and practices. Important consideration in this regards are the CBB's ability to share information and cooperate with the other supervisors. There is a need to require that, as a minimum, that the provisions on information sharing that appear in the IFSA are mirrored in the FIA.

156. A number of jurisdictions have found accountability and transparency are enhanced by having the Governor of the central bank appear regularly before an appropriate committee of the Parliament, to explain policy developments and take questions. Such a role might be envisaged for the Governor of the CBB.

157. The Supervision Department of the CBB might consider a more active role in the important task of increasing understanding in the community generally about the role, purpose and functioning of the regulatory structure supporting the banking industry. Part of this task could involve providing more wide ranging, timely data on aspects supervision. It could also involve replacing a lot of the implicit understandings that exist now between the

¹⁹ The International Financial Services Act deals with offshore banks. The International Business Companies Act, and its Regulations, also have a bearing on establishment.

bank supervisors and the banking industry with more codified, publicly available, rules and procedures.

158. The CBB should develop and promote its dispute handling role, and generally become more active in the consumer protection area. Banks should be required to alert their customers to the CBB's role in this area.

Table 18. Recommended Plan of Actions to Improve Observance of IMF's Code of Good Practices on Transparency in Monetary and Financial Policies—Banking Supervision

| Reference Practice | Recommended Action |
|---|--|
| V. Clarity of Roles, Responsibilities, and Objectives of Financial Agencies Responsible for Financial Policies | |
| | <ul style="list-style-type: none"> • The domestic legislation (the FIA) is largely silent on the relationship of the central bank with other regulatory agencies. The IFSA provides for the sharing of information. The FIA needs to be amended to provide for the sharing of information. • When the new payment system settles down, some thought should be given to whether the provisions in the FIA, which support the role of the CBB in the payment system, should be strengthened and made more transparent. |
| VI. Open Process for Formulating and Reporting of Financial Policies | |
| | <ul style="list-style-type: none"> • Bank supervision needs to do more to publicize and explain the supervisory arrangements. • A lot of the informal understandings between the supervisors and the banks should be regularized by developing publicly available rules and procedures. • The central bank needs clear authority to share information and sign MOUs. |
| VII. Public Availability of Information on Financial Policies | |
| | <ul style="list-style-type: none"> • There should be a greater provision of timely information on supervisory matters, and a wider availability of relevant data. • More publicity should be given to the CBB's role in handling complaints. |
| VIII. Accountability and Assurance of Integrity by Financial Agencies | |
| | <ul style="list-style-type: none"> • Thought should be given to having the Governor appear regularly before an appropriate Committee of the Parliament. • There should be an effort to achieve greater public awareness of the way bank supervision operates, what it hopes to achieve, and indeed what are its limitations, for example it does not guarantee the survival of a bank. • A Code of Conduct should be developed relevant to the |

| Reference Practice | Recommended Action |
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| | officers in Bank Supervision. |

Authorities' Response

159. The authorities were broadly in agreement with the assessment. They stressed, however, that the assessment of transparency practices should take into consideration individual country circumstances. This was particularly important for small island economies, where because of the small number of institutions and population, as well as personal and institutional interconnectedness, a literal application of the transparency code could be problematic.

C. Insurance Regulation

General

160. This assessment reviews the extent to which Barbados observes the IMF's Code of Good Practice on Transparency in Monetary and Financial Policies pertaining to Insurance Regulation. It was undertaken in the context of the FSAP for Barbados during June 24 to July 4, 2002. The assessment was carried out by Mr. C. C. Procter, a Consultant to the IMF, with relevant experience with the Reserve Bank of Australia, in collaboration with Mr. Craig Thorburn of the World Bank, who assessed compliance with the IAIS Insurance Core Principles.

161. Discussions were held with key staff of the Barbados Office of the Supervisor of Insurance. Extensive use was made of the Self Assessment Questionnaires prepared by the local authorities covering the IAIS Core Principles, and the IMF's MFP Transparency Code. The document 'Reform of the Supervision and Regulation of Financial Institutions – Barbados' prepared for the Ministry of Finance in 1997 provided some useful background.

162. The key pieces of Legislation are the Insurance Act 1996 (as Amended) and the Exempt Insurance Act (as Amended).²⁰

163. Offshore licenses are issued by the Minister of Finance (delegated to the Supervisor) whereas, in the domestic market, the Supervisor of Insurance has a more direct role. Compliance issues with the offshore companies rest with the Supervisor. Exempt (offshore) companies focus primarily on business from outside Barbados. Hence a number of issues significant to transparency in the domestic market do not apply to, or are less significant for, the offshore companies. This assessment accordingly focuses on the domestic insurance market, with specific references to the offshore sector where that seems appropriate.

²⁰ The Exempt Insurance Act deals with offshore companies.

164. Regulation of the insurance industry in Barbados is carried out by the Office of the Supervisor of Insurance. This is a public service function, responsible to the Minister of Finance. The Insurance Act provides the broad objectives and the institutional framework for the operations of the Supervisor.

Main Findings

165. The operations of the Office of the Supervisor, being located within the Finance Ministry, are somewhat opaque. Also, as presently configured, the ability of the Supervisor to relate effectively with other regulators is restricted.

166. The Supervisor should have a greater role in publicizing the operations of his Office, and the affairs of the industry. The prime source of information on the industry, the Annual Report of the Office, has not been prepared for some years; this omission should be repaired at the earliest opportunity.

167. More should be done to develop and publicize procedures and guidelines; comprehensive data should be regularly made available.

Table 19. Recommended Plan of Actions to Improve Observance of IMF’s Code of Good Practices on Transparency in Monetary and Financial Policies—Insurance Regulation

| Reference Practice | Recommended Action |
|---|---|
| V. Clarity of Roles, Responsibilities, and Objectives of Financial Agencies Responsible for Financial Policies | |
| | <ul style="list-style-type: none"> • As part of the Public Service, the activities of the Office of the Supervisor are not particularly transparent. Its operations need to be made more readily apparent. • The capacity of the Supervisor to work effectively with other regulatory bodies should be clarified and enhanced. |
| VI. Open Process for Formulating and Reporting of Financial Policies | |
| | <ul style="list-style-type: none"> • The Office of the Supervisor should have the ability to share information and tasks with other regulators, and negotiate relevant MOUs. • The Supervisor should develop a greater role in publicizing the workings of the insurance industry, and the regulatory and other roles of his Office. |
| VII. Public Availability of Information on Financial Policies | |
| | <ul style="list-style-type: none"> • The Office of the Supervisor has not prepared or submitted an Annual Report for a number of years. This should be a prime source of information on the workings of the Office and the industry. This omission should be remedied as a matter of priority. Comprehensive data on the industry should be compiled regularly, and made publicly available. • The Supervisor should take a more active role in publicizing the |

| Reference Practice | Recommended Action |
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| | affairs of his Office. <ul style="list-style-type: none"> • More directives and guidelines should be developed and made public. • The Supervisors consumer protection role should be developed and publicized. |
| VIII. Accountability and Assurance of Integrity by Financial Agencies | |
| | <ul style="list-style-type: none"> • The Supervisor should appear regularly before an appropriate public body to report on the workings of his office and conditions in the industry. • A Code of Conduct should be developed providing more specifically for the staff in the Office of the Supervisor |

Authorities' Response

168. The authorities are broadly in agreement with the assessment. They indicated that they have requested assistance through the CARTAC to strengthen supervision of the insurance sector which would also contribute to bringing transparency practices in line with international standards.

D. Securities Regulation

General

This assessment surveys the extent to which Barbados observes the **Code of Good Practice on Transparency in Securities Regulation**. It was undertaken in the context of the FSAP for Barbados during June 24 to July 4, 2002. The assessment was carried by Mr. C. C. Procter, a Consultant to the IMF with relevant experience in the Reserve Bank of Australia, in collaboration with Ms. Melinda A Roth of the World Bank, who assessed compliance with the IOSCO Core Principles.

169. Discussions were held with key staff of the Barbados Stock exchange/Barbados Securities Commission (see comments in paragraph 3), and with institutions in the market.

170. The key piece of Legislation is the Securities Act 2001-13. Extensive use was also made of the Self-Assessment Questionnaire compiled by the authorities for the IOSCO Core Principles. Useful data are available on the Barbados Stock Exchange web site.

171. A significant difficulty in making this Assessment is that implementation of the new Securities Act 2001 is not yet complete. This Act provides for a new Securities Commission oversight of the market. While the seven Commissioners have been appointed, staff are not yet in place and the Commission is well short of being fully operational. Some key staff are juggling roles in several bodies—the Commission, the Stock Exchange, and the Registry—during this transitional phase; this creates a significant lack of transparency, and potential conflicts of interest. When the new Commission is fully staffed and operational, it can

reasonably be expected that the transparency of the supervisory regime will be significantly enhanced.

172. The new Securities Act provided for the reconstitution of the stock market in the form of the Barbados Stock Exchange, with effect from August 2001.²¹ Additionally, the Act provided for the establishment of the Barbados Central Securities Depository Institution, as a wholly owned subsidiary of the BSE. The CSDI is regulated by the Securities Commission under its powers to administer the clearing and settling of securities. The CSDI has been given the capacity to handle both equities and government paper.

Main Findings

173. The new Securities Act provides a solid legal foundation for the development of the Barbados securities market. However, the Legislation has now been in place for 11 months, and much remains to be done to make it operational. In the transitional stage in which the securities market in Barbados finds itself at the moment, day-to-day operations are heavily dependant on a few key experienced staff, who often find themselves filling multiple roles.

Table 20. Recommended Plan of Actions to Improve Observance of IMF’s Code of Good Practices on Transparency in Monetary and Financial Policies—Securities Regulation

| Reference Practice | Recommended Action |
|---|---|
| V. Clarity of Roles, Responsibilities, and Objectives of Financial Agencies Responsible for Financial Policies | <ul style="list-style-type: none"> Developing and promulgating regulations and operating procedures; and rounding out appropriate delegations; needs to be given the highest priority. |
| VI. Open Process for Formulating and Reporting of Financial Policies | <ul style="list-style-type: none"> While the Commission can share information with other regulators, this may be something of a one-way street. The relationships between the three main regulators – the Securities Commission, the Supervision Department of the CBB, and the Insurance Supervisor – need to be regularized, and their ability to share information and tasks made secure. |
| VII. Public Availability of Information on Financial Policies | <ul style="list-style-type: none"> The BSE publishes useful information, but the informational role of the Commission is yet to be determined. There is a need to keep pushing out information about the workings of the securities market and its regulatory structure, to build public confidence. Regulations and procedures when promulgated should be made public. |

²¹ The Governor of the Central Bank is a Director ex-officio.

| Reference Practice | Recommended Action |
|--|--|
| VIII. Accountability and Assurance of Integrity by Financial Agencies | |
| | <ul style="list-style-type: none">• Internal governance procedures, including a Code of Conduct for the staff, need to be developed and published.• The Commission Chairman, and other senior officials, will have a key role in explaining the workings of the market. It would be useful to have them appear regularly before an appropriate public body, such as a back-bench Committee of the Parliament. |

Authorities' Response

174. The authorities are broadly in agreement with the assessment and considered the assessment to be fair. They stressed, however, that transparency practices in the area of securities regulation will be greatly enhanced once the Securities Commission becomes fully operational.

**BARBADOS AUTHORITIES' RESPONSE TO THE IMF FINANCIAL SYSTEM STABILITY
ASSESSMENT OF BARBADOS' OBSERVANCE OF THE IOSCO PRINCIPLES OF SECURITIES
REGULATION**

The authorities broadly agree with the assessment, although they would like to stress that the assessment should be considered in light of the fact that the Securities Commission (SC) was established just prior to the commencement of the FSAP exercise for Barbados. The creation of the SC is an important step toward bringing the regulation and supervision of the securities market in line with international standards. The functions and responsibilities of the Commission are defined in the *Securities Act*, which the FSAP mission judged to be comprehensive and well-drafted. The Chairman, six other Commissioners, and the General Manager responsible for the day-to-day operations of the Commission have been appointed, and other staffing is underway.

It is noteworthy that most of the IOSCO principles assessed by the FSAP mission have either been "implemented" or "partially implemented," with only two principles assessed as "not implemented." The FSAP mission also notes that the legal framework provides for many international best practices and the SC has the potential to act as a strong regulator and has comprehensive powers as well as the willingness to carry out its supervisory mandate. Once the Commission is fully staffed, implementation of the IOSCO principles is expected to be further enhanced. In particular, issuance of prudential guidelines, as well as risk-based prudential requirements are under consideration, and priority is being assigned to inspection, investigation, and surveillance activities. The authorities' response to the assessment of the observance of specific IOSCO principles are provided in the relevant section of the assessment.