

Eastern Caribbean Central Bank

The Eastern Caribbean Currency Union



Financial Stability Report

2019 | Issue No. 4

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The ECCB welcomes your questions and comments on this publication.



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The Financial Stability Report is a publication of the Eastern Caribbean Central Bank. It contributes to the Eastern Caribbean Central Bank's financial stability objective by identifying, monitoring and communicating on systemic risks. The view is to enhance the resilience of the ECCU financial system by taking action to reduce or remove any threat to financial system stability. This is a key strategic priority of the Eastern Caribbean Central Bank and supports the bank's objectives as it relates to growth, sustainability and employment.

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Abbreviations

AML/CFT	Anti-Money Laundering (AML) & Countering Financing of Terrorism
BSI	Banking Stability Index
CAR	Capital Adequacy Ratio
CB	Commercial Bank
CIBC	Canadian Imperial Bank of Commerce
ECCB	Eastern Caribbean Central Bank
ECCU	Eastern Caribbean Currency Union
FDI	Foreign Direct Investment
IFRS	International Financial Reporting Standards
LFI	Licensed Financial Institution
NBFI	Non-Bank Financial Institution
NFC	Non-Financial Corporations
NPL	Nonperforming Loan
RBS	Risk-Based Supervisory Framework
SICU	Systemically Important Credit Union
SRU	Single Regulatory Units
UK	United Kingdom
US/USA	United States of America

Country	ISO Code
Anguilla	AIA
Antigua and Barbuda	ATG
The Commonwealth of Dominica	DMA
Grenada	GRD
Montserrat	MSR
Saint Christopher (St. Kitts) and Nevis	KNA
Saint Lucia	LCA
Saint Vincent and the Grenadines	VCT

The following symbols are used:

E	Estimate
F	Forecast
Q	Quarter
RHS	Right Hand Side
LHS	Left Hand Side

Preface From The Governor

As the Eastern Caribbean Central Bank (ECCB) pursues its strategic objective of a strong, diversified and resilient financial sector, it is incumbent upon the ECCB, as the regulatory and monetary authority to remain accountable to the people of the Eastern Caribbean Currency Union (ECCU).

The 2019 edition is the fourth instalment of our Financial Stability Report and represents the continued work and efforts the ECCU's regulatory authorities to monitor, mitigate and report on systemic risk in the region. We thank all contributors.

Despite the current challenges faced by our regional economies, the analysis offered in this report provides considerable insight and evidence of the stability of our financial system during 2019. This stability could have only been achieved through the concerted efforts of our regulatory partners. This partnership continues to be enriching and serves to facilitate and protect the livelihoods of the citizens of the ECCU.

This edition of the Financial Stability Report (FSR) provides readers with an assessment of the main developments and vulnerabilities in the ECCU's financial system. The Report is divided into five (5) chapters:

1. Overview of Financial Stability in the ECCU
2. Financial Performance and Soundness of Deposit-Taking Institutions: Banking and Credit Union Sectors.
3. Financial Performance and Soundness of Non-Deposit-Taking Institutions: Insurance Companies.
4. Policy Initiatives for Enhancing Financial Stability in the ECCU.
5. Outlook.

The FSR identifies five main vulnerabilities within the financial sector and as with previous reports; charts and tables are used to highlight key information for ease of understanding. In this Report, we furnish you with an overview of the insurance sector and its role in financial stability in our region. Finally, new work has begun on the design of an optimal regulatory framework for the ECCU financial system, while the implementation of legislation to support developments within the financial space and the continuous enhancement of our supervisory arrangements continue.

1.0 Overview of Financial Stability in the ECCU

Global economic growth softened in 2019 and is expected to remain subdued into 2020. The ECCU financial stability report comes at a time when the world economy is transitioning into a state of heightened uncertainty, creating a challenging landscape for the ECCU banking sector. The current major challenges stemming from the external environment are; (i) increasing trade tensions between the USA and China, (ii) government shutdown in the USA, (iii) normalisation of monetary policy in the USA, (iv) geopolitical tensions and (v) uncertainty regarding the United Kingdom's (UK) exit from the European Union (EU).

Global economic growth was projected at 3.0 per cent in 2019 from 3.8 per cent in 2018. The weakness was broad based across advanced economies and largely attributable to the ongoing trade dispute between the USA and China and uncertainty from UK's exit from the euro area. Across the ECCU's key trading partners (USA, UK and Canada) growth decelerated sharply with the UK narrowly missing a recession. Economic growth in emerging market economies eased

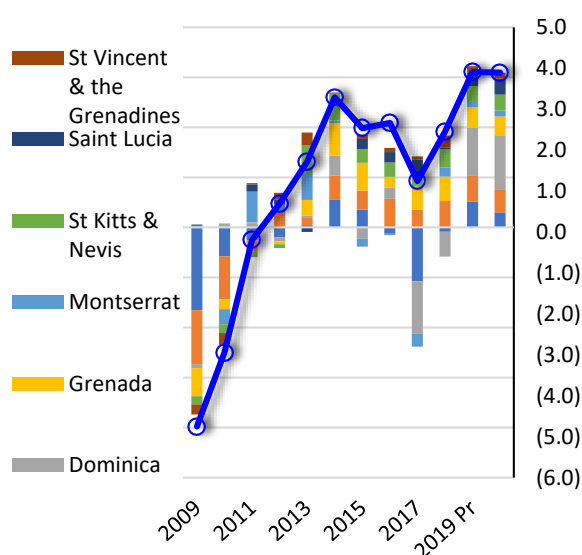
to 3.9 per cent in 2019 from 4.5 per cent in 2018. China was responsible for most of the weakness across emerging market economies.

Global growth is forecasted to accelerate mildly to 3.4 per cent in 2020. However, considerable uncertainty surrounds this outlook. The resolution of the USA/ China trade dispute is still uncertain and the Euro Area continues to exhibit signs of weak economic growth. Within this context, global growth could come in below these forecasts.

Domestically, output in the ECCU moderated to 3.3 per cent in 2019 from 3.8 per cent in the previous year (Error! Reference source not found.). Softer developments in FDI related construction output moderated economic growth, while resilient consumer spending and Government consumption expenditure contributed to the outturn. This has supported financial stability in the near term. However, vulnerabilities remain.

The economic outlook for the ECCU has softened since the last Financial Stability Report driven by global developments. Growth will ease to 3.2 per cent in 2020 and moderate further to 2.2 per cent in 2021. These forecasts are premised on an overall expansion in the construction sector, in addition to buoyant tourism activity.

Figure 1: ECCU Economic Growth Summary 2009-2019 (per cent change)



Downside risks to global and ECCU economic growth have become more pronounced in recent times. The risks to the ECCU growth outlook are tilted to the downside. These risks include the effects of persistent global uncertainty, an escalation in trade protectionism, a no-deal Brexit and weak performance of emerging markets, in particular a sharper slowdown in China.

Future GDP probability distributions derived from the Financial Stability Risk Index suggest a higher near-term tail risk to growth, with the probability of growth outturns below 2.0 per cent having risen by mid-2020 to approximately 20.0 per cent.

The ECCU financial system is deeply integrated with the real economy, particularly through the banking sector, which dominates the financial and economic landscape in the ECCU.

It is, therefore, important to the overall performance of the ECCU economy that the banking sector continues to operate profitably and efficiently for the long term, as this supports the financing of investments that enhance economic prospects.

However, the relationship is symbiotic, in that the banking sector is heavily exposed to some sectors of the economy. Problems in the domestic economy can weaken the financial system, if the problems cause large loan losses.

The banking sector's largest exposure is to households, particularly through mortgages. There is considerable opacity regarding the debt carrying capacity of households. Moreover, many new

borrowers have taken on large mortgages close to their maximum capacity to borrow. A richer discussion on this can be found below.

Overall, domestic lending is gradually recovering but asymmetric across segments of the financial sector. While credit growth in the banking sector is slowly rising; in the credit union sector, growth in credit has remained buoyant. Furthermore, lending to NFC's remained subdued, growth in mortgage lending moderated while spending on consumer durables has accelerated. The overall level of NPLs has declined; however, banks ought to employ greater effort to achieve larger and continued reductions in their stock of legacy NPLs.

Finally, the commercial banking sector continues to undergo a transformation, as acquisitions of operations by regional and international banking groups are announced. These include, the Republic Financial Holdings Ltd.'s acquisition of the banking business of the Bank of Nova Scotia, the GNB Financial Group Ltd.'s announcement of the acquisition of 66.7 per cent of CIBC FirstCaribbean shares from CIBC. Finally, the recently announced the sale of

the Eastern Caribbean operations of Royal Bank of Canada (RBC) to a consortium of indigenous commercial banks within the ECCU.

1.1 Key Risks and Vulnerabilities

Risk to the stability of the ECCU financial sector were moderate during 2019 amid changes in the economic and financial landscape. The financial system remained resilient to a broad range of economic risks. The banking sector maintained buffers of capital and liquidity over current requirements and has achieved strong profitability. However, some parts of the insurance and credit union sectors exhibited less resilience and faced challenges. Key risks to the stability of the financial sector are slower economic growth (prospectively), hurricanes and low investment yields.

Economic expansion across the Currency Union along with moderate credit growth has contributed to the soundness and stability of the financial system. In addition, the strengthened supervisory and regulatory framework has contributed to this stability and soundness.

The main risk factors affecting the stability of the ECCU financial system are identified below:

(i) Increasing share of non-bank financial institutions in credit intermediation – Non-bank financial institutions have increased their share of credit intermediation over the last few years. Not only credit unions but also finance companies. Competition continues to increase in the credit market driven by a search for higher yields and maintaining or expanding market share, amid pressures from technological advancements. This could lead to a downward spiral in underwriting standards. Further, with limited market size added to the opacity in information on borrowers, the financial position of lenders could weaken the financial sector, which is already confronted with too much debt and slow growth. The growth of non-bank financial intermediation - which has allowed firms to improve risk-sharing and diversify their funding sources - can also be associated with increased risk-taking and rising interconnectedness between financial sectors, which may act as a contagion channel in the event of distress.

Unregulated non-banks such as finance companies (e.g. car dealerships) could spread contagion to the rest of the financial sector. Their exposure to unsecured credit could weaken their balance sheets and ultimately have a negative impact on bona fide financial institutions.

(ii) Low interest rates- Interest rates continue to fall not only globally but also at the ECCU level. Lower interest rates can affect financial stability through a range of channels, including: (i) encouraging investors to seek higher returns by taking on greater risk; (ii) increasing the value of long-term assets (and liabilities) and increasing the volatility of asset values; and (iii) increasing debt and leverage, in part because assets become more expensive to purchase.

Low interest rates can therefore have a range of financial stability consequences. Several particularly pertinent consequences for the ECCU include: exacerbating existing financial system vulnerabilities due to high levels of household debt; encouraging households to shift to riskier, higher-yielding investments without

understanding the risks; increasing banks' deposit funding costs relative to benchmark interest rates (if banks need to compete more with alternative, higher-yielding investments); and causing losses for insurers that have long duration claims liabilities (e.g. some life insurers), by increasing the value of these liabilities.

(iii) Downside risks to economic growth –

Global growth softened in 2019 and is expected to remain weak into 2020. Likewise, growth has moderated at the ECCU level and could weaken in the near term. In an environment of lower growth, this presents idiosyncratic risks to the financial sector. The growth-at-risk (GaR) models prepared by the ECCB indicate that should global economic growth fall below 2.5 per cent in 2019 an ensuing recession is projected for the ECCU by mid-2020. Given the symbiotic relationship between the financial sector and the real economy we can expect the financial sector to become stressed.

(iv) Natural Disasters - The increasing frequency and intensity of natural disasters are likely to have a negative impact on the financial sector and the real economy. For example, the passage of a hurricane can cause widespread damage to the real economy through the destruction of agriculture and infrastructure. Furthermore, borrower's financial positions may be affected through job and income losses as well as damage to physical collateral, which can significantly affect the financial sector. These effects also lead to an increase in the cost of insurance and can place upward pressure on both the cost of construction and home ownership. Thus, households may choose to underinsure their properties.

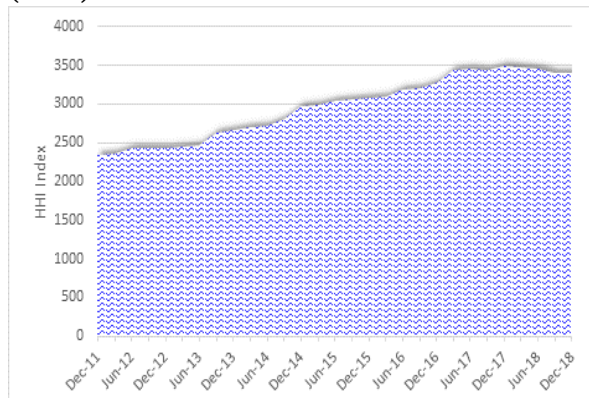
(v) Cyber security risk - as financial institutions continue to adopt technology to drive business, their exposure to cyber-crimes is expected to increase.

Vulnerabilities in the ECCU banking sector have carried over from 2018; among the vulnerabilities are elevated concentration in the loan portfolio and non-performing loans.

- i. **Concentration** - Loan portfolios within the commercial banking sector are becoming increasingly concentrated on the household sector; the increasing exposure to households and in particular mortgage debt, increases vulnerabilities.

The concentration of commercial bank credit has played a major role in systemic banking crises across the world¹. As at December 2019, the concentration of banks loan portfolios was at 3,448 points, a 24-point reduction from the December 2018 index, **(Figure 2)**. Although a marginal reduction was recorded, the overall trend has been upward, with most of the concentration being in the personal sector, predominantly loans for land and home acquisition. Close to 60.0 per cent of commercial bank's lending is concentrated in the personal sector.

Figure 2: Hirschman Herfindhal Index (HHI) of Loan Concentration



Source: Eastern Caribbean Central Bank (ECCB)

- ii. **Elevated NPLs-** The ratio of non-performing loans to total loans in the financial sector remains high. In the banking sector it has remained well above the 5.0 per cent prudential benchmark. Within the credit union sector, non-performing assets are in the range of close to EC\$500.0m representing an NPL ratio of 6.8 per cent. These non-performing assets weaken the ability of these institutions to record profits, which affects their capital position to absorb shocks. When this vulnerability is interacted with growing downside risks to the

¹ According to a 2004 Basel committee study, credit concentration of banks caused 9 of the 13 major banking crises around the world in the twentieth century (Westernhagen et al., 2004). It is fair to say that bank asset concentration also contributed significantly to the two major banking crises that the twenty-first century has witnessed so far. The

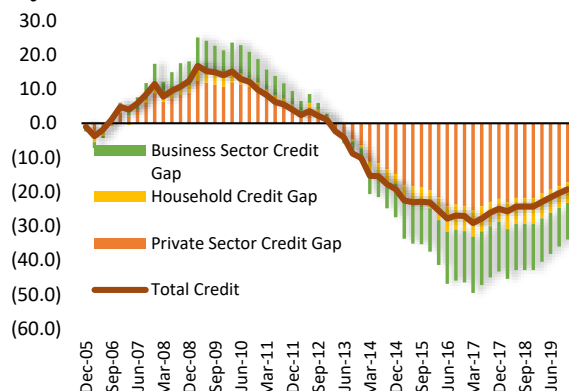
simultaneous overexposure of several banks to the U.S. mortgage market initiated the global financial crisis '07-'08 (Brunnermeier, 2009), and the overexposure of several banks to sovereign debt of distressed European countries severely deepened the European debt crisis of '11-'12 (Acharya et al., 2014).

growth outlook the financial sector could be adversely impacted.

1.2 Cyclical Risk

Cyclical risk in the financial sector remained low. Credit growth still expanded less slowly than the rate of growth of nominal GDP growth, which resulted in a negative credit to GDP gap, (Figure 3). With credit growing at a slower pace than GDP, credit excesses are still contained but asymmetric across the financial sector. In the credit union sector, credit continues to deepen at a rapid pace raising questions regarding the sustainability and carrying capacity of debt in this sector. To contain any negative repercussions from this development the authorities need to intensify their oversight of credit unions or implement measures to slow the growth of credit.

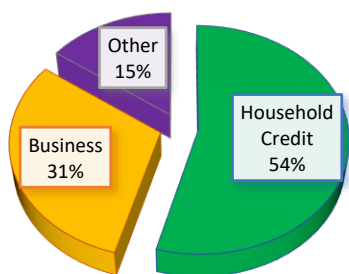
Figure 3: Credit to GDP Gap (Financial Cycle)



Household Credit

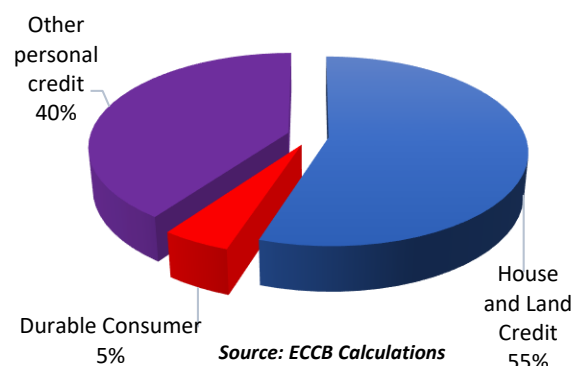
Credit intermediaries are heavily exposed to household credit; initial estimates suggest that at the end of 2019 household credit accounted for 54.0 per cent of total credit in the financial system, (Figure 4). Though the pace of credit to households eased in 2019, institutions are increasingly exposed to households. The financial health of households is important for the financial system. Households are vulnerable to cyclical downturns in the economy, which may cause income loss and possibly loan defaults. A high level of debt can pose risks by increasing potential losses to lenders. It can also increase the likelihood of sharp cuts in consumption, especially by highly indebted households, which may amplify a downturn. This in turn increases the risk of losses to lenders on all forms of lending. Additionally, the efficiency of the financial system can be compromised if high levels of household debt inhibit the flow of credit to creditworthy borrowers.

Figure 4: Distribution of Credit by Segment



Approximately 54.0 per cent of bank lending is to the household sector, which gives rise to a concentrated loan portfolio, with particularly large concentrations of debt for the acquisition of property, (mortgage related debt). Mortgages represent 30.0 per cent of all lending and 55.0 per cent of the total credit extended to households, (Figure 5).

Figure 5: Composition of Household Credit



1.4 Interconnections

The risk of contagion in the financial sector continue to rise in 2019.

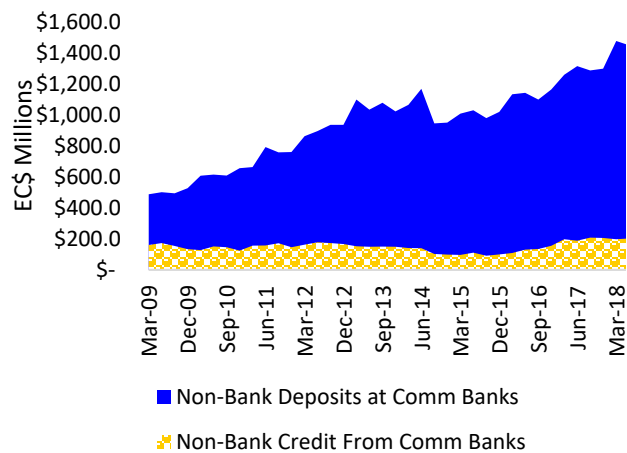
Interconnections in the financial sector are established through the evolution of assets and liabilities as well as common exposures and ownership. At the end of 2019, interconnections, as measured through lending and deposits between the banking sector and the NBFIs sector, continued to increase, (Figure 6). Banks also continue to increase their exposure to NBFIs (Figure 7), which raises the potential for further contagion jumping from one sector to the next.

For example, the significant exposure of the largest and most connected bank in the region to the NBFIs sector may lead to significant effects if these deposits are lost. However, given the high levels of liquidity in the banking sector, it is possible that these stresses can be absorbed.

Other transmission channels for contagion risk may be established between banks and sovereigns. Risks emanating from the domestic banking sector can weaken a country's public finances, especially where troubled banks require intervention and government support, while domestic sovereign risk can weaken bank's balance sheets through defaults on government debt or a significant drawdown of government deposits. However, given the improvement

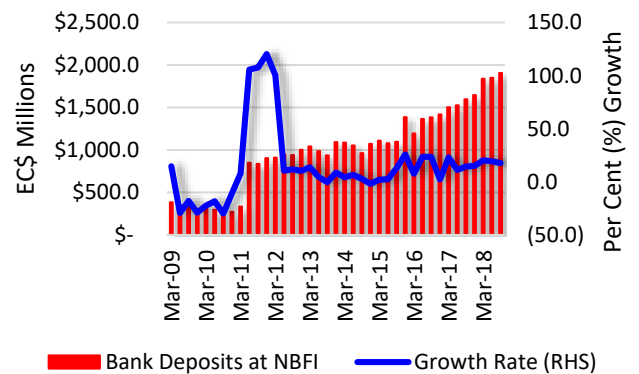
in public finances and improvements in the banking sector, the probability of this risk and its potential impact is estimated to be low in the near to medium term.

Figure 6: Interconnections as measured by Deposits and Loans



Source: Eastern Caribbean Central Bank (ECCB)

Figure 7: Bank Deposits at Non-Bank Financial Institutions (NBFIs)



2.0 Financial Performance and Soundness of Deposit-Taking Institutions: Banking and Credit Union Sectors

2.1 Banking Sector

Overview

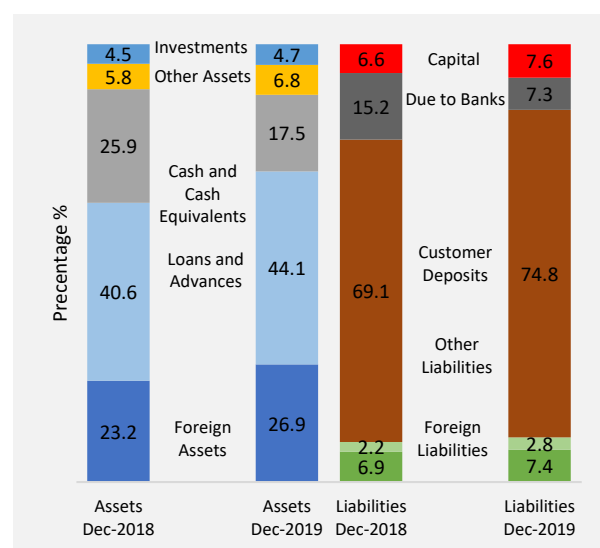
The commercial banking sector remained stable and buoyant over the review period. The bank stability index (BSI), which is a general indicator of the sector's overall performance, trended upwards in 2019. This is reflective of improving profitability, asset quality, capital positions, and liquidity conditions. Commercial banks continue to hold a large proportion of the assets in the financial system. As at the end of 2019, the total assets of the banking sector were estimated at 138.0 per cent of ECCU GDP.

Developments

In 2019, the total assets of the commercial banking sector declined by 6.5 per cent to \$28.8 billion. Total assets held by the sector had exhibited positive growth for the last five years. The decline was due to a pronounced reduction in interbank activity, that is, banking entities are holding significantly less interbank deposits. All other major asset categories expanded over the period relative to the previous year,

including loans and advances and foreign assets. Resident loans increased by 0.6 per cent while non-resident loans increased by 20.5 per cent. Figure 8 provides a breakdown of the aggregate balance sheet of the CBs.

Figure 8: Major Balance Sheet Components of ECCU CBs



Despite the downsizing of the balance sheet, customer deposits increased by 1.3 per cent to \$21.5 billion. Customers' deposits accounted for 74.8 per cent of total liabilities at the end of 2019 compared to 69.1 per cent at the end of 2018. Total loans to total deposits remained stable at 58.9 per cent, increasing only marginally from its previous level.

Overall, commercial banks continued to hold a sizeable amount of liquid assets. The ratio of liquid assets to total assets increased by 3.8 percentage points to 40.2 per cent at the end of 2019 from 36.4 per cent at the end of 2014. As it relates to capital adequacy in the sector, the CAR for 2019 was 21.2 per cent, which is an increase of 2.0 percentage points relative to the end of 2018 levels. Tier 1 capital to risk-weighted assets increased from 16.9 per cent at the end of 2018 to 17.5 per cent at the end of 2019. The quality and level of regulatory capital held by the commercial banks has increased consistently over the past five years.

Commercial banks in the region maintained their profitability in 2019. Reflecting a controlled decline in operating expenses, the sector's ROE increased by 3.4 percentage

points to 19.67 per cent. Similarly, the sector posted ROA of 1.4 per cent at the end of 2019 compared to 1.1 per cent at the end of 2019. This is the largest recorded ROA since 2009.

Exposures

Over the review period, commercial banks increased their total extension of credit to the economy. Total loans and advances grew by 1.4 per cent with total private sector credit expanding by 0.5 per cent. The total level of loans and advances by commercial banks now stands at \$12.8 billion. On average, credit to the individual sub-sectors increased by 3.7 per cent. Further, the household, government, tourism, and distributive trade sectors accounted for approximately 80.0 per cent of total outstanding loans (Table 1).

Table 1: Distribution of Credit by Sector, % share (2014 – 2019)

	2014	2015	2016	2017	2018	2019
Agriculture	0.4	0.4	0.3	0.3	0.3	0.3
Construction and land development	8.0	7.8	6.6	6.3	6.6	5.9
Distributive trades	8.0	7.7	7.6	7.3	7.3	7.0
Entertainment & catering	1.1	1.0	1.0	0.8	0.8	0.8
Financial institutions	0.4	0.8	0.8	1.1	1.3	1.7
Fisheries	0.1	0.1	0.1	0.1	0.0	0.0
Government services	7.2	8.2	8.1	8.7	9.7	9.7
Manufacturing	1.5	1.5	1.4	1.3	1.1	1.2
Mining & quarrying	0.4	0.4	0.4	0.2	0.2	0.2
Personal	51.1	52.4	54.5	56.7	55.2	54.7
Professional and other services	8.3	8.1	8.2	6.7	6.2	6.5
Tourism	9.9	8.5	7.7	7.2	7.3	8.0
Transportation & storage	1.8	1.7	1.5	1.6	1.4	1.6
Utilities	1.8	1.5	1.9	1.6	2.4	2.3

Households continue to be the dominant borrowers in the sector, accounting for over 50.0 per cent of all loans. However, in recent periods commercial banks have increased their exposures to other borrowers. For instance, between 2014 and 2019, total credit to non-residents and governments have increased 23.0 per cent and 27.0 per cent respectively. Conversely, commercial banks have reduced their exposure to private businesses with leverage to business borrowers down 27.0 per cent over a five year period.²

Concentration of Lending to Households

Lending to the private sector accounts for 88.0 per cent of all lending by commercial banks. In 2019, households received 62.0 per cent of all credit extended to the private sector. Observing the credit categories relative to GDP, a strong downward trend is visible from high levels between 2009 and 2012 (Figure 9). During that period household debt to GDP levels averaged 42.2 per cent. They still remain elevated (33.4 per cent in 2019) compared to the other categories and have resurged at a slower pace than business credit.

² Since 2015, the average annual growth of credit to private business has been minus 6.0 per cent, while

for non-residents it is 4.9 per cent and 5.1 per cent for the public sector (governments).

Generally, household sector indebtedness has declined to levels below historical averages.

Figure 9: Credit Categories as a Percentage of GDP

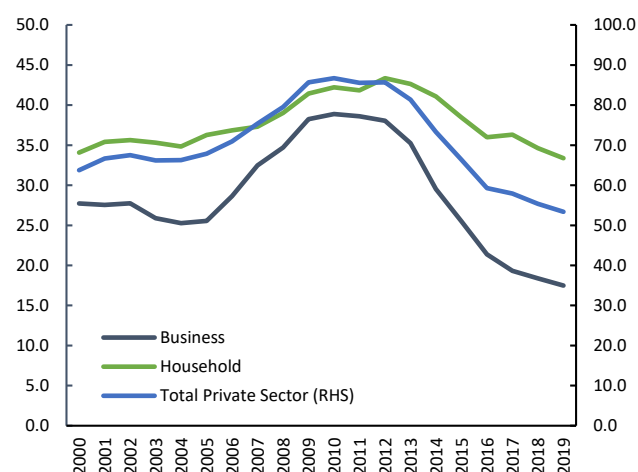
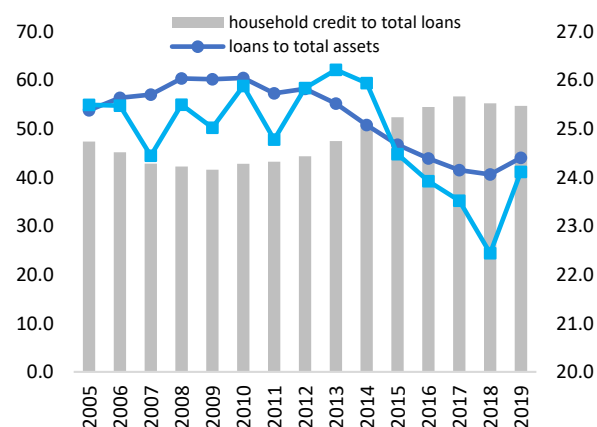


Figure 10: Household Lending as a share of CBs Assets and Loans



Commercial banks' exposure to households increased in 2019, though it accounted for less of their credit portfolios. Relative to

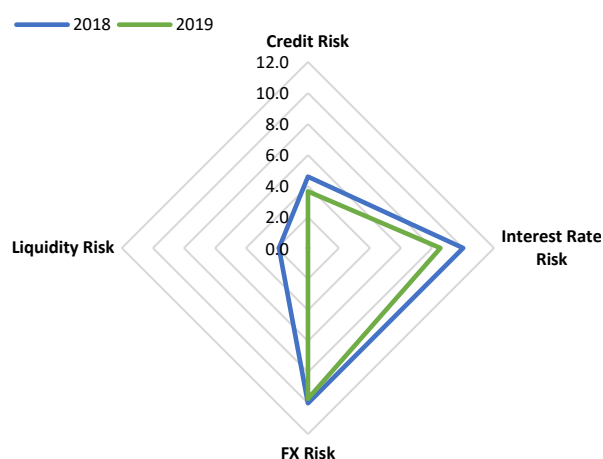
CBs total assets, household credit increased 1.7 percentage points to 24.1 per cent. As a percentage of total loans it accounted 54.7 per cent at the end of 2019 compared to 55.2 per cent at the end of 2018. There is greater concentration within the household segment, with mortgage lending (being the bulk of the credit extended by the commercial banks. The concentration within the household sector as measured by the Herfindahl-Hirschman Index (HHI) was 4,711.7.³ The mortgage market has become quite attractive to households with residential mortgage rates declining to lows of 4.3 per cent or 75 basis points below the rates available just two years prior (figure 10).

Risk Assessment

The banking sector continues to be exposed to a number of financial risks. These include those related to market, credit, and liquidity conditions. The risk levels are summarized in figure 11. Overall, commercial banks exhibited a general improvement in their risk exposures.

³Markets with HHI values above 2,500 points are considered to be highly concentrated.

Figure 11: Risk Summary of CBs



Notes: Shifts towards the origin reflect a decline in CBs' risk exposures while movements away from the origin reflect increased risk. Credit risk is captured by the NPL ratio; Interest rate risk is captured by a static maturity gap (estimated); Foreign exchange risk is represented by the net open position in percentage of capital; The liquid assets/total assets indicator captures Liquidity risk.

There was an improvement in liquidity positions as measured by the liquid assets to total assets indicator. In 2019, commercial banks' liquid assets increased by 3.8 percentage points, accounting for 40.2 per cent of total assets. Deposits continue to be the main funding source at 74.8 per cent of total funding, it accounted for 69.1 per cent in 2018. However, with loan to deposit ratios of about 59.0 per cent, funding liquidity risks are relatively subdued. The net open position to capital of the banking sector declined by

5.0 percentage points to 162.5 per cent. The net open position has been elevated for a several periods trending significantly above the 20-year average (86.1 per cent).⁴ It has display a large amount of volatility.

The interest rate risk (IRR) faced by the banking sector declined marginally in 2019. Large IRR exposures could potentially impact the present value of the CBs future cash flows, resulting in changes to rate-sensitive assets, liabilities, and off-balance sheet items.⁵ The estimated maturity gap in the loan book declined to 11.6 years at the end of 2019 from 12.1 years at the end of 2018. This is indicative of an improvement because of the narrowing gap.

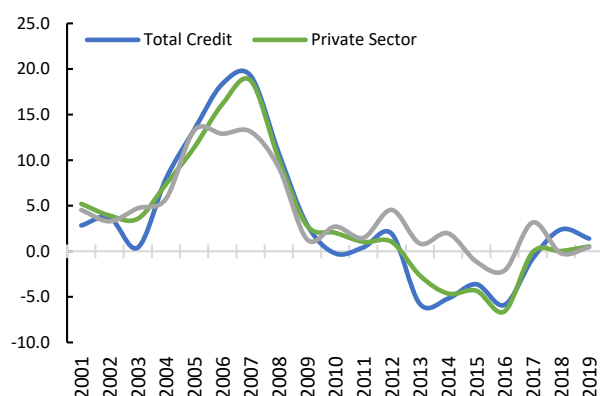
Lastly, commercial banks had a lower average exposure to credit risk over the review period. The nonperforming loan ratio continued to improved, decreasing by 1.2 percentage points to 10.1 per cent. It was recorded at 11.3 per cent in 2018 and has receded by 8.0 percentage points since 2014 when it peaked at 18.1 per cent. Much of the improvement in asset quality observed in the sector was influenced by improved

⁴ Majority of the foreign currency exposures are US dollar denominated, which the peg currency of the Eastern Caribbean Currency Union. This essentially nullifies any foreign exchange risk.

⁵ There are many ways in which IRR can manifest in commercial banks. For the traditional bank focused on intermediation, it is commonly because of the difference in maturity between their assets and liabilities.

underwriting practices and economic conditions. There were also write-offs and overall increases in the banking book. There is also no indication of excessive credit dynamics that could result in a build-up and unwinding in the future. As Figure 12 shows credit growth in the major categories remain well below historical and pre-crisis levels.

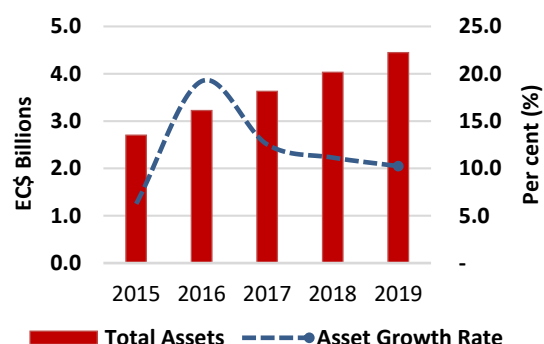
Figure 12: Credit Growth in Main Lending Categories



2.2 Credit Union Sector

Total assets, loans and deposits expanded marginally for December 2019 relative to December 2018. Total assets for the credit union sector increased to EC\$4.1b in December 2019 from EC\$4.0b in December 2018. This represents a 10.2 per cent increase in assets; slightly lower than the 11.2 per cent growth rate recorded for December 2018. (Figure 13).

Figure 13: Total Assets of Credit Unions in the ECCU

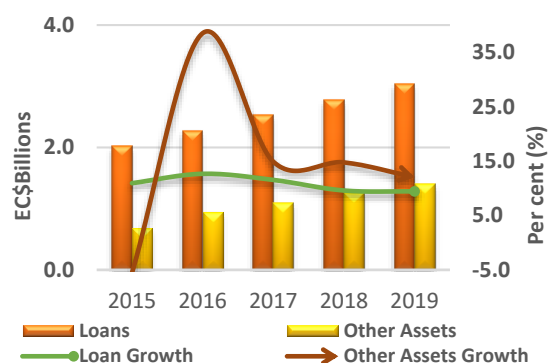


**Source: Single Regulatory Units in the ECCU and ECCB staff*

Loans, which accounted for 68.5 per cent of the sector's total assets as at December 2019, increased to \$3.0b up from EC\$2.8b reported for December 2018. The increase in loans was 0.2 per cent lower than the 9.6 per cent increase reported in 2018. Nevertheless, the rise in total loans likely signifies an increase in demand for finance as well as an easing in lending terms and conditions that allows for easier access to finance.

Non-loan assets grew by 12.0 per cent; however similar to loans, the growth in non-loan assets was slightly lower than the growth reported in December 2018 (Figure 14).

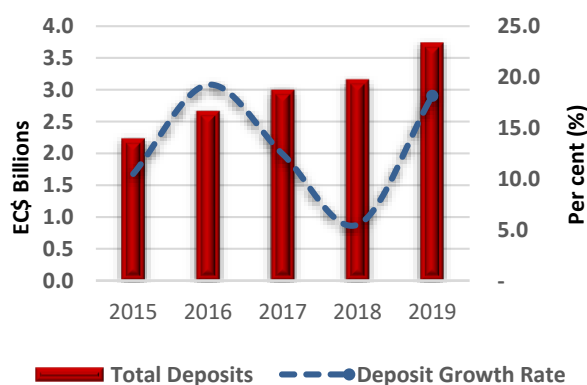
Figure 14: Loans and Non-Loan Assets of Credit Unions in the ECCU



*Source: Single Regulatory Units in the ECCU and ECCB staff

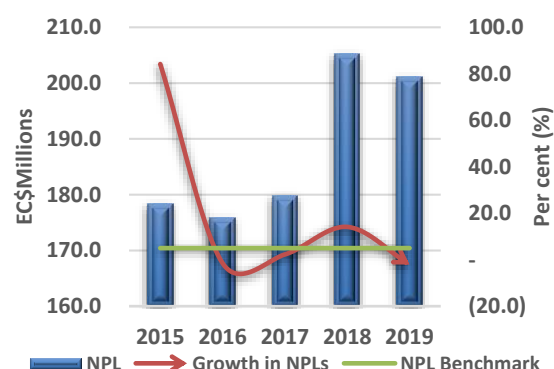
Total deposits for the sector increased by 18.2 per cent to EC\$3.7b for December 2019 compared to the level at the end of December 2018 (Figure 15). The increase in the rate of growth in deposits suggests increase confidence of the public in the credit union sector.

Figure 15: Total Deposits of Credit Unions in the ECCU



Non-performing loans fell by 2.0 per cent to EC\$ 201.0m in December 2019, down from EC\$205.0m in December 2018. The NPL ratio for the sector stands at 6.6 per cent or 1.6 percentage points above the 5.0 per cent benchmark.

Figure 16: Non-Performing Loans and Non-Performing Loans Benchmark



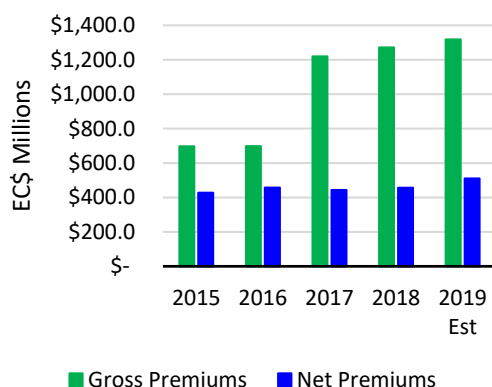
The credit union sector in six of the eight countries report NPL ratios above the 5.0 per cent benchmark.

3.0 Financial Performance and Soundness of Non-Deposit-Taking Institutions: Insurance Companies

3.1 Overview

Activity in the insurance sector of the ECCU remained buoyant in 2019, gross premiums are estimated to have risen by roughly 4.1 per cent. Net premiums remained relatively stable at around 60.0 per cent of the total premiums written suggesting ECCU insurers continue to enjoy access to reinsurance markets. At the end of 2019, gross premiums are estimated to have increased to EC\$1.32b or roughly US\$489.0m, from EC\$ 1.27b in the previous year (Figure 17).

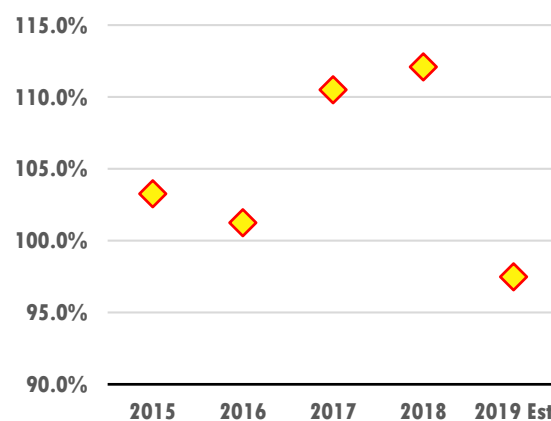
Figure 17: Gross and Net Premiums ECCU Insurers



Claims costs for general insurers have been relatively stable following large claims cost

in 2017 which spilled over into 2018 due to damages caused by hurricanes. As a result, general insurers have reported relatively healthy profitability in 2019. The combined ratio is used as the metric for assessing the profitability of the insurance sector, for 2019 the combined ratio fell to 97.6 per cent from 112.3 per cent in 2018, (Figure 18). The main reason for the improvement in the ratio is due to lower claims payments which helped to improve the loss ratio.

Figure 18: Combined Ratio ECCU Insurance Sector



Source 1: Single Regulatory Units

ECCU insurers continue to maintain solvency margins in excess of what is

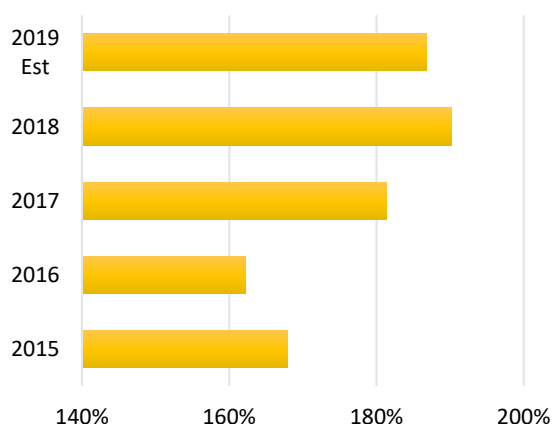
required by law⁶. As at the end of 2019 the solvency margin was estimated at 187 per cent meaning that insurers assets were on average 87.0 per cent higher than their

liabilities, (Figure 19). Companies that have ratings with AM Best continue to report stable ratings outlook up 2020, (Table 1).

Table 2: Selected Ratings, ECCU Insurance Companies

Company	Ratings	Outlook	Date of Rating
Caribbean Alliance Insurance Co. Ltd	A (Excellent)	Stable	29-Oct-19
Guardian General Insurance Limited	A- (Excellent)	Stable	30-Dec-19
Guardian Life of the Caribbean	A- (Excellent)	Stable	30-Dec-19
Gulf Insurance	B+ + (Good)	Stable	2-Sep-19
Island Heritage Insurance Co. Ltd.	A (Excellent)	Stable	4-Oct-19
Massy United Insurance Ltd	A- (Excellent)	Stable	5-Aug-20
National General Insurance Corporation (NAGICO)	B+ + (Good)	Stable	7-Feb-20
Pan American Life Insurance of the Eastern Caribbean Ltd	A (Excellent)	Stable	21-Aug-19
East Caribbean Reinsurance Company Limited (ECRC)	B+ (Good)	Stable	8-Oct-19
Sagicor General Insurance Inc.	A- u (Stable)	Stable	20-Sep-19
Sagicor Life Insurance Company	A- u (Stable)	Stable	20-Sep-19

Figure 19: Average Solvency Margin ECCU Insurance Sector



The main risk that confronts the insurance sector in the ECCU is climate change, which increases the frequency and intensity of hurricanes in the region. 2016 and 2017 are two years in which the sector was affected significantly as result of hurricanes. Unsustainable government debt levels pose a risk to insurers as restructuring of these instruments can affect their solvency and credit ratings. Low interest rates pose a challenge to some insurers especially those with exposure on international capital

⁶ There are slight variations in law across the ECCU countries and across type of insurance company, but

they all arrive at the same metric which assets must be in excess of liabilities to remain solvent.

markets. Lower interest rates reduce their profitability; however, investment income is not the main source of revenue for insurers but rather premium income.

Challenges for the sector in the medium term include transitioning into the new IFRS 17 standard which will have some impact on the sector. This transitional arrangement will impact the way insurers record

premium collection and ultimately their profitability. Repricing is another major risk facing the insurance sector, for insurers the price of reinsurance is likely to increase as disasters become more frequent and larger. On the consumer side increasing prices are likely to force many out of the market which could lower insurance penetration and coverage.

4.0 Policy Initiatives for Enhancing Financial Stability in the ECCU

Overview

Policy Initiatives remain the same from the last FSR and therefore a full exposé of them is not presented. In the ECCU, several initiatives are expected to assist in enhancing financial stability. These include; (1) new supervisory arrangements including the proposed regulation of the Caribbean Credit Card Corporation (4Cs), (2) establishment of a regional deposit insurance scheme, and (3) development of a macroprudential framework.

4.1 New Supervisory Arrangements

Within the ECCB, the Bank Supervision Department (BSD) works to mitigate the risks to the financial system and supports monetary policy of a strong and stable Eastern Caribbean Dollar. The Bank Supervision Department has instituted a risk-based supervisory (RBS) framework. The RBS is a comprehensive, formally structured system that assesses risks within the financial system, giving priority to the resolution of those risks. Work on the implementation of Basel II/III remains ongoing. Simultaneously, the BSD

continues to work on the development of an AML/CFT framework for licenced financial institutions (LFIs) under the Banking Act. Additionally, the BSD continues to implement Information Technology assessments as part of their RBS framework.

As of 2018, the ECCB is in the process of establishing regulations for the Caribbean Credit Card Corporation (4Cs) and as such the engagement is ongoing. Additionally, discussions are ongoing for the regulation of SICUs in the ECCU. To date, the ECCB has worked towards the development of a framework for identifying systemically important financial institutions. It is anticipated that upon completion and adoption, the framework will be used for both commercial banks and credit unions.

4.2 The Establishment of the ECCU Credit Bureau

The Harmonised Credit Reporting Bill was developed to provide for the proper administration and licensing of credit bureaus. Additionally, the Bill provides for the compilation and maintenance of databases, evaluation, update and dissemination of the data to subscribers and

other data related adjustments. Enactment of the Bill, however, remains outstanding in three (3) member countries having not been passed in the Parliaments of Anguilla, the Commonwealth of Dominica and Saint Lucia. Additionally, enforcement of the Act remains outstanding in Montserrat and Saint Vincent and the Grenadines. Supervision and oversight of the proposed credit reporting system will be conducted by the ECCB. It is expected that upon passage in all member countries that the establishment of the Credit Bureau will address the issue of asymmetric information. This should accelerate the speed at which credit applications are processed. Thus, providing credit-granting firms with greater means to assess and adequately price risk to facilitate the extension of credit to the ECCB member countries.

4.3 The Establishment of the Eastern Caribbean Deposit Insurance Corporation

Work continues on the establishment of a deposit insurance scheme for the ECCU region. The ECCB received technical assistance in 2019 to commence the drafting of the law.

4.4 Macprudential Policy

The ECCB continued to work towards the development of a macroprudential policy framework for the ECCU region. The goal of this framework is to assess risks across the entire financial sector and make recommendations on an appropriate course of action to stymie any activity that threatens the stability of the financial sector. Several initiatives have already been achieved toward this goal, including the development of a suite of indicators to assess stability and the publication of three prior Financial Stability Reports (2016, 2017 and 2018). Additionally, the establishment of a Regional Financial Stability Committee and the enactment of legislation to give the ECCB powers to undertake macroprudential policy are outstanding and are important steps to achieve this goal. The timely sharing of information by the SRUs is another important step towards the realisation of this goal.

5.0 Outlook

The ECCU financial sector remained stable throughout 2019. Most indicators point to moderate risk. The credit to GDP gap, a measure of the financial cycle is still negative but entering into an expansionary phase.

Nonetheless, vulnerabilities persist and new risk have come to the fore. The vulnerabilities, which persist, stem especially from the legacy NPLs in the commercial banking system, along with

elevated levels of concentration on lending portfolios.

Risks have evolved since the last FSR. They stem largely from the slowdown in economic growth and the increasing trend in interconnections especially in one country. A more protracted slowdown in growth could help amplify those pre-existing vulnerabilities in the financial sector. Especially NPLs and weak profitability.

Given the levels capital in the financial sector, the sector is expected to remain stable even in the face of slower growth. Notwithstanding, increased supervision of the sector is warranted as this juncture given the potential risks on the horizon.

