The Financial System

The Central Bank maintained its focus on addressing financial system vulnerabilities in 2012, seeking to build greater resiliency and robustness through regulatory reforms, macro-prudential oversight and projects aimed at improving the efficiency of the financial infrastructure.

Notable progress was made in addressing the level of commercial bank non-performing loans (NPL) as loan provisioning directives that were issued by the Central Bank just prior to the start of the year took effect. Elicited by the rise in the NPL ratio that reached a peak of 16.1% at the end of 2010, the new loan loss provisioning standards specified that up to 70.0% of the loan value should be set aside to cover non-performing loans that are collateralized by mortgages. Commercial banks were required to make minimum monthly or quarterly provisions that would enable full compliance with the revised standards over a three-year transition period. Two banks were granted conditional approval to reach full compliance within a five-year period because of the size of their required adjustments. Subsequent loan write-offs and the phasing in of the provisioning standards over the twelve month period resulted in the NPL ratio falling from 14.5% to 11.0%.

Another important milestone was the successful revision of the Banks and Financial Institutions Act (BFIA) to conform the regulatory framework to international standards and improve administrative efficiency. The new Domestic Banks and Financial Institutions Act, 2012 (DBFIA), was approved by parliament in August 2012 with the date for effectiveness slated to be 1 January 2013. Among its legal stipulations are greater transparency and controls on related party transactions to minimize insider dealings, improved corporate governance through board oversight committees, the adoption of International Financial Reporting Standards (IFRS) by all banks, the establishment of financial holding companies in order to separate the banking activities of a company group from its other commercial businesses, the institution of administrative penalties to discourage non-compliance with Central Bank directives and an improved resolution structure to minimize systemic disruptions.

Efforts to address the shortcomings revealed in the Caribbean Financial Action Task Force (CFATF) Mutual Evaluation Report of 2011 were also heightened, as the Central Bank established an anti-money laundering (AML) unit that is staffed by three bank examiners, two of whom are Certified AML Specialists.

During the year, on-site AML compliance examinations of five credit unions, two domestic banks and two international banks were completed. With technical assistance from the IMF, the Central Bank began taking steps toward the improvement of its capacity to identify money laundering vulnerabilities in the financial system. Meetings were held between various stakeholders and a team of IMF consultants who will be providing guidance on the drafting of a manual that covers on-site and off-site AML monitoring procedures.

The Central Bank's longstanding focus on the viability of individual financial institutions was broadened as the Bank assumed explicit responsibility for stability of the financial system as a whole. In August, a Financial Stability Unit was established under the supervision of a committee comprised of senior personnel of the Research and Financial Sector Supervision Departments. The unit's mandate is to establish a framework for macro-prudential surveillance with a view to identifying financial sector vulnerabilities and recommending strategies for risk mitigation. The first tasks undertaken were a review of Belize's financial sector and an assessment of the current administrative architecture for financial stability oversight in order to identify regulatory gaps or areas for improvements in the analytical tools and data collection methods currently in use.

As part of the Bank's initiative to modernise Belize's financial infrastructure, further strides were made toward the establishment of a national credit bureau with assistance being received from the Canadian International Development Agency (CIDA) and the International Financial Corporation (IFC). The credit bureau project is aimed at improving credit risk assessment and increasing the efficiency of credit distribution. Project developments in 2012 included the Central Bank's initial review of the draft credit bureau law, which will be forwarded for further review to a Legal and Regulatory Working Group that was formed during the year. The latter is comprised of various organizational stakeholders and is mandated to evaluate legislative options in the quest for an appropriately supportive regulatory framework. Preliminary discussions were held with key stakeholders such as the Belize Social Security Board (BSSB) and the Bureau of Standards to seek their cooperation in the development of a credit database and the dispute resolution process. A Request for Solution (RFS) was also drafted, and this will be made available to potential suppliers of credit bureau services to facilitate the selection process.

Project targets in 2013 include the obtaining of parliamentary approval for the Credit Report Act, 2013, the co-hosting of a Credit Reporting Conference for the major stakeholders, the issuance of a Credit Bureau license and the launching of a campaign to heighten awareness of credit reporting across the nation.

Supervision Issues

In fulfillment of its mandate for financial system safety and soundness, the Central Bank conducted on-site examinations of two domestic banks, two international banks and two credit unions. Bank examiners focused on statutory compliance issues including adherence to anti-money laundering/counter terrorist financing regulations and assessed institutional viability and performance as it relates to solvency, liquidity, capital adequacy and risk management.

The commercial banks submitted seventeen applications for credit facilities that exceeded 25.0% of their paid-up and unimpaired capital and reserves to the Central Bank as required by section 21(2) of the BFIA. Approval was granted for nine facilities that amounted to $150.5mn, compared to the five facilities summing to $38.1mn that were approved in the previous year.

Domestic Commercial Banks

Notwithstanding $37.3mn in loan write-offs, commercial bank assets expanded by 7.5% to $2,744.5mn and included increases of 24.6% in cash and balances due from banks, 17.2% in government securities and 2.6% in loans and advances to customers, with the latter representing a rebound from 2011's 0.3% contraction.

The year 2012 represented the first full year of the commercial banks' phased implementation of the new loan loss provisioning requirements and the result was a 41.3% ($32.5mn) rise in the system's loan loss provisions. Additional loan write-offs led to a 7.2% reduction in non-performing loans to $310.mn (as compared to a 3.3% increase in 2011) while the NPL ratio fell from 14.5% in 2011 to 11.0%.

On the liabilities side, deposits rose by 10.9% to $2,289.7mn, more than doubling the previous year's 5.2% increase. In view of the continued growth in liquidity, banks were reluctant to roll over higher-cost time deposits, so the bulk of the growth was in demand and savings deposits, which expanded by 54.6% and 19.2%, respectively. While time deposits decreased by 6.5% for a second consecutive year with its share of total deposits shrinking from 52.0% to 45.0%, demand deposits rose from 22.0% of total system deposits to 31.0%.

Domestic Commercial Banks

Chart 3.1: Assets, Loans and Non-Performing Loans

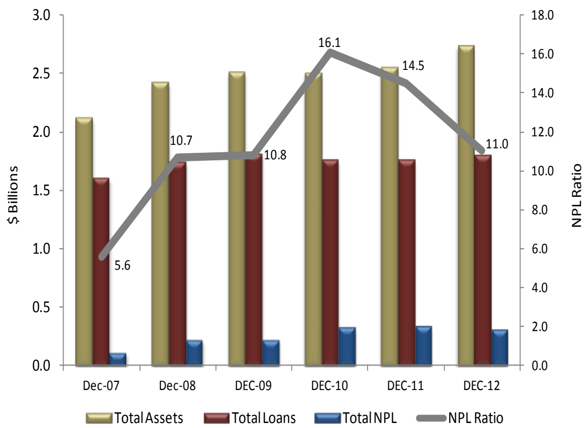


Chart 3.4: Efficiency of the Domestic Banking System

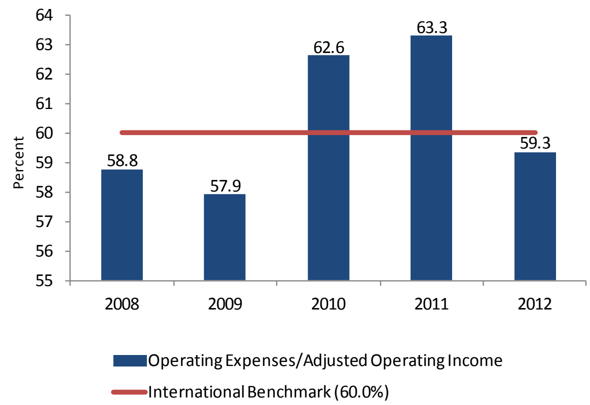


Chart 3.2: Capital Adequacy Ratios

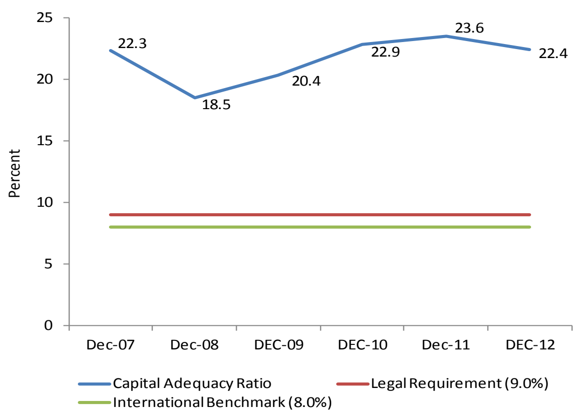
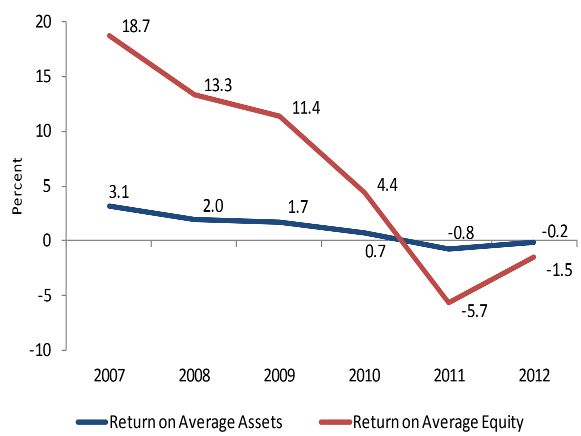


Chart 3.3: Profitability Ratios



Retained earnings posted an 8.3% decline partly due to the loan write-offs and more stringent loan loss provisions and this in turn resulted in a 4.4% contraction in the primary capital of the commercial banks, which stood at $353.9mn. Notwithstanding this, the overall capital adequacy ratio (CAR) of the domestic banking system stood at 22.4% at year-end, with individual CARs ranging from 9.7% to 55.0%, all of which were above the 9.0% legal requirement and the minimum internationally accepted requirement of 8.0%.

The balance sheet adjustments made by the commercial banks resulted in an overall loss of $4.8mn, which was substantially less than the $20.8mn loss recorded in 2011. As a result of the loss, the return on average equity (ROE)

Five Largest Credit Unions

Chart 3.5: Loans, Assets, Cash and Balances Due from Banks

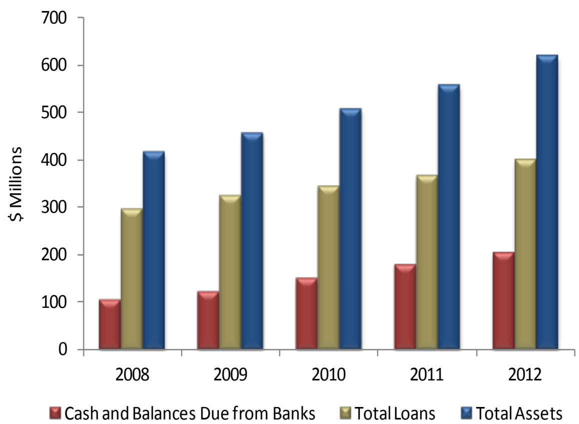


Chart 3.6: Non-Performing Loans

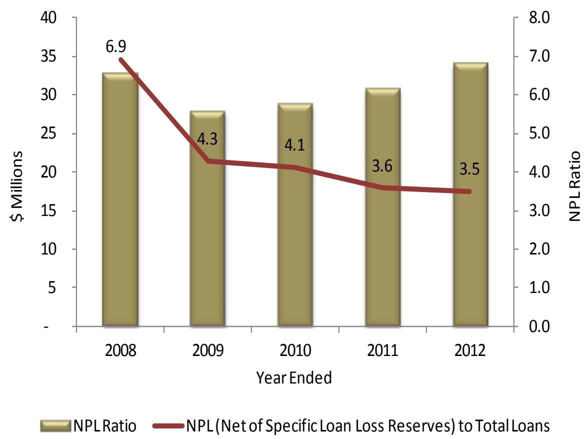
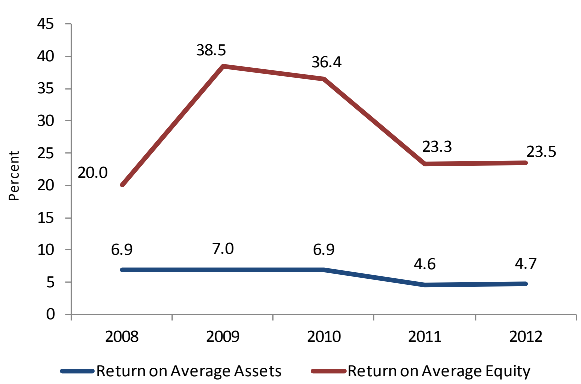


Chart 3.7: Profitability



went from -5.7% in 2011 to -1.5%, and the return on average assets (ROA) went from -0.8% to -0.2%. Meanwhile, the downward drift in deposit interest rates led to a 30.8% contraction in interest expenses that in turn contributed to an improvement in the industry's efficiency indicator, which fell from 63.3% to 59.3% in 2012, just below the international benchmark ceiling of 60.0%.

Credit Unions

Credit union activity continued to trend upward during the year with the assets of the five largest credit unions (the Group) growing by 10.8%, an expansion that reflected increases of 9.9% in loans to customers and 13.2% in liquid assets (cash and balances due from banks). While the Group's NPL increased by 10.6% to $34.1mn, the growth in loans combined with a 12.9% rise in specific loan loss provisions, caused the NPL ratio to decline from 3.6% in 2011 to 3.5%. This marked the fourth consecutive year of declines in the ratio, which continues to be below the 5.0% international benchmark.

Since 2009, when the credit unions had been required to reclassify and divide member shares into the mandatory minimum capital required for membership and the balance as share deposits, total capital has grown steadily, recording a 9.0% increase to $115.8mn in 2012. On the other hand, the ratio of net institutional capital to total assets fell from 10.5% in 2011 to 9.5%, which is just below the 10.0% international benchmark. The net profits of the Group rose by 1.0% to $25.1mn resulting in increases in the ROA (from 4.6% to 4.7%) and ROE (from 23.3% to 23.5%).

International Banks

Chart 3.8: Assets, Loans and Non-Performing Loans

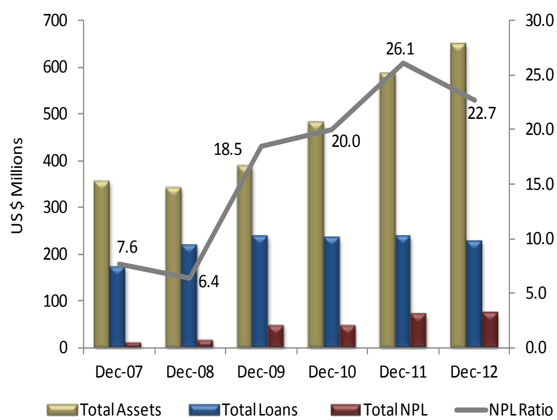


Chart 3.9: Capital Adequacy Ratio

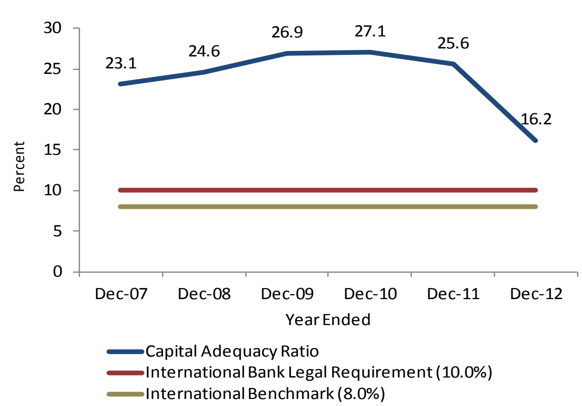
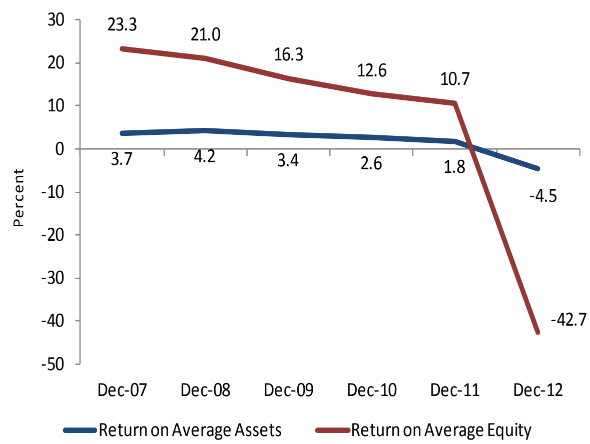


Chart 3.10: Profitability



In August 2012, British Caribbean Bank International Limited was granted permission to revert to the name it previously held, i.e. Belize Bank International Limited.

Unlike the domestic banks and credit unions, there was a deceleration in the asset growth of the international banks from 21.7% to 10.7%. While their cash and balances due from banks and government securities/investments recorded a combined increase of 25.0%, loans and advances declined by 4.4% in contrast to the 1.0% growth that had occurred in 2011. Specific loan loss provisions expanded by 131.7% versus a 3.0% increase in NPL, and the NPL ratio consequently fell from 26.1% to 22.7%.

Deposit growth decelerated from 24.2% to 13.3%, and in their drive to control costs, the international banks presided over a moderate shift in the composition with the share of demand deposits rising from 55.0% of total deposits to 58.0% and that of savings and time deposits falling from 16.0% to 12.0% and from 23.0% to 19.0%, respectively.

Capital nosedived by 34.9% due to the sharp increase in specific loan loss provisions that resulted in a decrease in the industry's CAR from the 25.6% recorded in 2011 to 16.2%. However, the latter continued to be well above the legal requirement of 10.0% and the 8.0% minimum international benchmark.

Because the one-off spike in specific loan loss provisions eclipsed an US$8.3mn growth in non-interest income, a net loss of US$27.7mn was recorded in 2012, compared to the US$6.6mn in net profits realised in the previous year. The ROE and ROA of the international banks consequently fell from 10.7% in 2011 to -42.7% and 1.8% in 2011 to -4.5%, respectively.