



AN ASSESSMENT OF FINANCIAL SOUNDNESS OF THE CREDIT UNION SECTOR IN THE BAHAMAS (2008-2015)

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Abstract

Credit unions, whose motto is “people helping people”, play a systemically important role in The Bahamas and in the wider Caribbean. Given the increasing sophistication in consumer choice and demands on credit unions, enforcing and strengthening the regulatory framework is vital. This paper, therefore, seeks to provide a detailed picture of the operations of the credit union sector in The Bahamas and an analysis of their soundness indicators. The analysis was conducted in the context of the PEARLS (Protection, Effective Financial Structure, Asset Quality, Rates of Return and Costs, Liquidity and Signs of Growth) monitoring system, which has emerged as the prudential standard for the sector worldwide, and the CAMELS (capital adequacy, asset quality, management, earnings, liquidity and sensitivity to market risk) framework which serves to complement existing financial soundness indicators. The general findings of the paper were that, in most instances, the sector was in compliance with prudential benchmarks and does not pose a threat to financial stability in The Bahamas.

JEL Codes: G23, E02

KEYWORDS: Prudential Indicators, PEARLS, CAMELS

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The views expressed in this paper are those of the author and do not necessarily represent The Central Bank of The Bahamas. This paper should be considered a work in progress and as such the author would welcome any comments on the written text.

SECTION 1: INTRODUCTION

Credit unions have been expanding steadily in recent years, providing important financial intermediation, particularly for middle and lower income groups. As such, there has been an increasing overlap of financial services with banks, but credit unions are not banks. Credit unions, unlike commercial banks and other microfinance institutions (MFIs), are member-owned, not-for-profit financial cooperatives that provide savings, credit and other financial services to their members. Members benefit from higher returns on savings, lower interest rates on loans and fewer fees on average. The said type of institution provides services to groups that share a common interest or something in common (workplace, church). Their key objective is to provide a secure and convenient place where members can save their money and also avail themselves of loans at reasonable prices. Credit unions operate by using the pooled savings of its members to raise funds that can be passed off to members at low interest rate loans.

Credit unions differ from traditional banks and financial institutions, in that they are not-for-profit and dividends are paid to members. However, banks and other financial institutions are for-profit and operate for the benefit of shareholders. In addition, banks are owned and controlled by stockholders, whose main interest is to obtain a return on their investment. However, while both types of institutions are operated by a board of directors, traditional banks appoint a board of directors, while for credit unions members elect a volunteer board of directors from their membership and each member has one vote in board elections, regardless of their amount of savings or share in the credit union.

The credit union sector has been growing in importance over the past decade, with membership and business rapidly expanding, due to higher deposit rates, the low interest rates offered on loans and the relatively easy access to credit. As a result, inadequately regulated credit unions could potentially undermine financial stability and thus there is need for a strengthening of regulation and supervision to reduce such vulnerabilities.

Regulation would involve the development, consultation, introduction and enforcement of appropriate legislations, regulations and guidelines for these institutions. Meanwhile, effective supervision consists of dynamic assessments of the operations of the institutions to ensure they continue to operate in a safe and sound manner, while complying with their supervisory requirements. Active supervision would ensure that in cases where prudential issues or concerns are identified, intervention would be on a timely basis.

This paper, therefore, seeks to conduct an analysis of this important sector, examining the safety and soundness principles that are in place, with a view to determining if they are in compliance with the PEARLS and CAMELS performance monitoring regimes. Following the introduction, Section II will feature a historical overview of credit unions in The Bahamas. A succinct analysis of the PEARLS and CAMELS framework, the two main systems used to assess the health and soundness of credit unions, will be undertaken in Section III, after which an analysis of Bahamas' credit union financial soundness indicators will be conducted in Section IV. Section V will highlight some policy recommendations for the sector in The Bahamas and the paper will conclude with some general findings.

SECTION 2: HISTORICAL OVERVIEW OF CREDIT UNIONS IN THE BAHAMAS

The Cooperative movement in The Bahamas was established in 1974, with the enactment of the Cooperative Societies Act 1974 (the Act), the first cooperative legislation introduced in the country. Subsequently, the Department of Cooperative Development was formed in 1975 to administer the Act and it was charged with the promotion, formation, registration, regulation and control of cooperative societies. The initial credit union to register under the Act was the National Workers Cooperative Credit Union in 1976.

The credit union league, which comprises the membership of all of the large active unions, was formed in April 1977, by the then four (4) existing credit unions. The purpose of the League was to facilitate the operations of the sector through the promotion of education in credit union techniques, distribution of specialized stationary and liaisons with Government and non-government organisations. Currently, all registered credit unions are eligible for membership and is required to pay an annual premium to support the Leagues. Further, on a voluntary basis, credit unions maintain a stabilization fund with the League in the event liquidation proceedings is necessary for any member.

The League also liaised with the international credit union movement, which was affiliated with the Worldwide Council of Credit Unions in Wisconsin. In 1995, the League became affiliated with the International Credit Union National Association of the United States (CUNA Mutual), facilitating access to a wide range of services, including deposit and loan insurance. At the time of its affiliation, The Bahamas was one of the meagre three (3) Caribbean countries to have become members of CUNA.

Over the years, total assets maintained an upward trajectory, although the total number of active credit unions in The Bahamas has been declining. During the period 2008-2015, the number of active credit unions reduced to 9 from 13, following a number of consolidations and liquidations. Nevertheless, aggregate assets totalled \$370.6 million in 2015, representing an average annual growth of 7.1% over the past eight (8) years. Within the sector there is a high degree of concentration with one (1) firm dominating the market, accounting for 51.3% of total assets. The remaining six (8) entities held smaller shares, ranging between 4.1% and 15.3% of the aggregate. Total assets comprised mainly of loans—63.5% of total in 2015—with lesser amounts in the form of fixed deposits, fixed assets and cash balance. A further disaggregation of the loan portfolio revealed that the bulk (73.7%) of the sector's loans is of the consumer nature.

Given the sector's heightened intermediation of funds, and the Government's desire to rationalize the financial regulatory landscape, the decision was made to bring credit unions within the regulatory and supervisory remit of the Central Bank. In this context, the Central Bank in 2011 took definitive steps towards assuming regulatory and supervisory oversight of credit unions. To aid in the transition exercise, the Government secured technical assistance from the Commonwealth Secretariat in August 2011, under a two-year institutional strengthening project, which was managed by the Central Bank. As a result, on June 1, 2015 the Central Bank assumed full regulatory and supervisory responsibility for the sector.

SECTION 3: FINANCIAL SOUNDNESS FRAMEWORK FOR CREDIT UNIONS

3.1. PEARLS FRAMEWORK

Credit unions offer numerous financial products that help people maximize their incomes and increase their savings, and often they have fewer or lower fees than the traditional banks. As a result, based on World Council of Credit Unions (WOCCU) field experience with credit unions globally, a set of target indicators have been developed and these are referred to as the International Credit Union Safety and Soundness Principles. These safety and soundness principles, which identify prudential standards intended to safeguard credit union members' savings from losses and to ensure credit unions function in a sound manner, consist of a set of performance indicators, each with a minimum prudential norm that credit unions should meet. To assist credit unions and their regulators in monitoring financial performance relative to these Principles, WOCCU in 1987 developed the PEARLS monitoring system. The acronym stands for Protection, Effective Financial Structure, Asset Quality, Rates of Return, Liquidity and Signs of Growth (see Table 1). These six groups of indicators, which are industry benchmarking tools, focus on the health of financial institutions and propose a system of forty-four (44) financial ratios.

According to the PEARLS financial soundness framework, the **P** which stands for protection evaluates the extent to which credit unions can provide a safe environment to protect their members' funds. The main performance indicators used in this assessment are the allowance for loan losses, net allowance for loan losses, complete loan charge and solvency ratios.

Further, the **E**, which denotes effective financial structure, gauges the financial structure of credit unions by appraising sources and uses of funds. The financial structure is deemed effective when assets, financed by savings deposits, generate sufficient income to pay market rates on savings, cover operating expenses and maintain capital adequacy. A key indicator used to deduce the effective financial structure is institutional capital to total assets ratio and this should be maintained at 10% (minimum prudential norm). In terms of institutional capital, this is the second line of defense to protect savings², since each year a portion of the credit union's earnings should be set aside in reserves which will be used to cover losses from unforeseen or catastrophic problems.

The **A** represents asset quality and measures overall quality of assets. It identifies the impact of non-earning assets on credit union income. The primary performance indicators used in this assessment are the total delinquency to total loan portfolio ratio and the non-earning assets³ to total assets ratio. The benchmark is for both of these ratios to be less than 5%. Therefore, credit unions should limit non-earning assets to a maximum of 5% of their total assets and invest 95% of its funds into those assets that earn a return greater than the combined cost of funds and operating costs.

² Provisions for loan losses are the first line of defense to protect savings against identified risk of losses to the credit union. WOCCU recommends that at least 35% of loans past due from 1 to 12 months be provisioned into an allowance account and those past 12 months be provisioned at a 100%, and written off as loss from the books on a quarterly basis.

³ Non-earning assets include land, buildings, vehicles, furniture and cash owned by the credit union.

Further, the **R**, relates to rate of return and costs. It monitors the return on all types of assets (uses of funds), as well as the costs of each liability and examines how yields and costs affect the growth of the credit union. The net loan income to average net loan portfolio and the net income to average assets are some of the performance indicators used.

The **L** stands for liquidity and examines the ability of the institution to meet its present and anticipated cash flow needs, including funding loan demand, share withdrawals and liabilities and expenses. The World Credit Union Council found that credit unions should maintain a minimum ratio of 15% of withdrawable savings in easily accessible instruments and accounts. The main prudential ratio assessed is the liquid assets minus the short-term payables to total deposits ratio, which should be maintained at a minimum of 15%. The liquidity reserves to total savings deposits are also used and the minimum prudential norm is 10%.

Signs of growth are symbolized by the **S**, which looks at the growth in various areas in credit unions, with a view to gauging member-client satisfaction and to assist management in maintaining an effective financial structure.

Overall, PEARLS has emerged as the prudential standard for credit unions operating worldwide, since it provides standardized financial ratios which are used for assessing the financial performance of credit unions. It is solely quantitative and was originally designed as a management/benchmarking reporting tool, but later became an effective supervisory mechanism. More importantly, it complements CAMELS, which is the main framework for assessing the health of financial institutions.

Table 1: PEARLS FRAMEWORK	
Performance Indicators	Minimum Prudential Norm
Protection	
Allowance for Loan Losses Delinquencies > 12 months	100%
Net Allowance for Loan Losses Delinquencies 1-12 months	35%
Complete Loan Charge-off of Delinquency > 12 months	Yes
Solvency (net value of Assets/Total Shares & Deposits)	>=111%
Effective Financial Structure	
Net Loans/Total Assets	70-80%
Liquid Investments//Total Assets	<16%
Financial Investments/Total Assets	<2%
Non-Financial Investments/Total Assets	0%
Savings Deposits/Total Assets	70-80%
External Credit/Total Assets	0%-5%
Member Share Capital/Total Assets	<20%
Institutional Capital/Total Assets	>10%
Net Institutional Capital/Total Assets	>10%
Asset Quality	
Total Delinquencies/Total Loan Portfolio	<= 5%
Non-Earning Assets/Total Assets	<= 5%
Net Zero Cost Funds/Non-earning Assets	>= 200%
Rates of Return and Costs	
Net Loan Income/Average Net Loan Portfolio	Entrepreneurial Rate
Net Income/Average Assets (ROA)	Enough to reach the goal for Institutional Capital
Liquidity	
Liquid Assets - ST Payables/Total Deposits	15%
Liquidity Reserves/Total Savings Deposits	10%
Non-earning Liquid Assets/Total Assets	<1%
Signs of Growth	
Growth in Total Assets	>Infl. + 10%
Growth in Liquid Investments	10%
Growth in Savings Deposits	70%-80%
Growth in Institutional Capital	> = 10%
<i>Source: World Council of Credit Unions</i>	

3.2. CAMELS FRAMEWORK

The National Credit Union Administration (NCUA) implemented the CAMELS monitoring system for credit unions in 1987. The CAMELS system, which is the main framework used by financial institution regulators internationally to assess financial institutions, including credit unions, is designed as a supervisory tool and is driven by both component and composite ratings. The Uniform Financial Institutions Rating System (UFIRS) was implemented in the United States in 1979 and later adopted globally. CAMELS, which is the abbreviation for **C**apital adequacy, **A**sset quality, **M**anagement soundness, **E**arnings and profitability, **L**iquidity and **S**ensitivity to market Risks, is a supervisory rating system, which evaluates these six (6) components of a deposit taking financial institution's performance (see Table 2). Therefore, the CAMELS, a supervisory tool, rely on on-site examinations and examiners' qualitative opinions, for assessing the health and soundness of financial institutions. Financial, managerial and compliance factors common to all financial institutions are evaluated in a uniformed and comprehensive manner.

The objectives of the CAMELS framework involve reviewing and assessing financial institutions, including credit unions capital adequacy (C), to determine how well they manage shocks to their balance sheets. The focus is on the capital position of institutions to support loan portfolio growth and potential deterioration in assets. Further, CAMELS appraise and gauge the quality of the assets (A) with emphasis on investments and loans; looking at exposure of assets in the institutions' portfolios to various risks. The CAMELS framework also examines the overall soundness and effectiveness of management (M) of institutions/credit unions by evaluating and assessing governance and management oversight, including human resources, processes, controls and audit. In addition, CAMELS look at credit unions adequacy of earnings and profitability (E), focusing on their ability to absorb losses by amassing a satisfactory capital base, finance expansion and pay dividends to shareholders. The liquidity (L) status and adequacy is another major objective of the CAMELS framework. This aspect of the framework scrutinizes the capability of credit unions to meet their present and anticipated cash flow needs, including funding loan demand, share withdrawals and other expenses. Sensitivity to market risk, symbolized by the S, examines the sensitivity of loans and deposits to sudden adjustments in interest and exchange rates.

CAMELS ratings are assigned based on a ratio analysis of the financial statements, combined with on-site inspections by a supervisory regulator. The rating system is designed to take into account and reflect all significant financial and operational factors examiners assess in their evaluation of an institution's performance. Institutions are rated using a combination of specific financial ratios and examiners' qualitative judgements.

The ratings are assigned on a scale from one (1)—which indicates strong performance—to five (5)—which signifies unsatisfactory performance. Credit unions with ratings of 1 or 2 are considered to have few, if any, supervisory concerns, indicating strong to satisfactory performance and risk management practices that consistently provide for sound operations. Conversely, credit unions with ratings of 3, 4 and 5 represent moderate to extreme degrees of supervisory concern, suggesting flawed, unsatisfactory or poor performance. Such performance, by itself or in combination with other weaknesses, directly impairs the viability of the credit union.

Table 2: CAMELS FRAMEWORK	
Performance Indicators	Benchmark/Prudential Indicators
Capital Adequacy	Regulatory capital to risk-weighted assets Regulatory tier 1 capital to risk-weighted assets
Asset Quality	Non-performing loans to total gross loans Non-performing loans net of provision to capital Sectoral distribution of loans to total loans
Management	Overall soundness and effectiveness of management of the institutions by examination of governance, human resources, processes, controls and audit
Earnings and Profitability	Return on Assets Return on Equity Net interest margin to gross income Non-interest expenses to gross income
Liquidity	Liquid assets to total assets Liquid assets to short-term liabilities
Sensitivity to Market Risk	Net open position in foreign exchange to capital
<i>Source: Federal Financial Institutions Examination Council, 1979</i>	

Specifically, for capital adequacy (C), a rating of one (1) is accorded for credit unions that maintain a level of capital fully commensurate with their current and expected risk profiles and can absorb present and anticipated losses. In addition, capital levels are maintained at least at the statutory net worth requirements and there are no significant asset quality problems, earnings of deficiencies, exposure to credit or interest rate risk that could adversely affect capital. Further, a capital adequacy rating of two (2) is given to a credit union that maintains a level of capital as those rated one (1), but, its capital position is not as strong overall, although in this category they should be in a position to meet their risk-based net worth requirement. A rating of three (3) reflects a level of capital that is at least at the “undercapitalized” net worth category and is an indication that there may be asset quality problems, earnings deficiencies, or exposure to credit or interest rate risk that could affect the credit union’s ability to maintain the minimum capital levels. Therefore, credit unions in this category may be unable to meet their risk-based net worth requirements. Meanwhile, if the credit union is “significantly undercapitalized”, but asset quality, earnings, credit or interest rate problems will not result in the credit union becoming critically undercapitalized in the next 12 months then a rating of four (4) is conferred. In the case where the credit union is critically undercapitalized, or has significant asset quality problems, negative earnings trends or high credit or interest rate risk exposure that could result in it becoming critically undercapitalized in the next 12 months, a rating of five (5) is bestowed. This is the lowest rating and credit unions in this category are exposed to levels of risk sufficient to jeopardize their solvency.

With respect to asset quality (A), a rating of one (1) indicates high asset quality and minimal portfolio risks. Further, lending and investment policies and procedures are documented in writing, conducive to safe and sound operations and are adhered to. A rating of two (2) symbolizes high quality assets, albeit the level and severity of classified assets are great in a one

(1) rated institution. Generally, credit unions that are rated one (1) and two (2) show trends that are stable or positive. In the instance where there is a significant degree of concern, based on current or anticipated asset quality problems, a rating of three (3) is bequeathed. Nevertheless, credit unions in this category may have only a moderate level of problem assets, although they may be experiencing negative trends, inadequate loan underwriting, poor documentation, higher risk investments, inadequate lending and investment controls and monitoring that suggest a reasonable probability of expanding levels of problem assets and high risk concentration. Ratings of four (4) and five (5) indicate increasingly severe asset quality problems, with both experiencing the same issues as in a rating of three (3). However, in a rating of four (4) there is a high level of problem assets that will threaten the institution's viability if left uncorrected, while a rating of five (5) signals that the viability has deteriorated due to the corrosive effect of its asset problems on its earnings and capital levels.

In terms of management (M), the component rate is determined based on the board of directors' and management's ability to identify, measure, monitor and control the risks of the credit union's activities, and ensure compliance with applicable laws and regulations. A rating of one (1) indicates that management and directors are fully effective, while a two (2) suggests minor deficiencies, but a satisfactory record of performance is produced. With a three (3) rating, either operating performance is lacking in some measures or other conditions exist, such as inadequate strategic planning or inadequate response to NCUA supervision. A rating of four (4) signals that there are serious deficiencies in management's ability or willingness to meet its responsibilities, while five (5) is applicable in cases where incompetence or self-dealing has been clearly demonstrated.

A credit union's viability is dependent on its ability to earn an appropriate return on its assets (E), which aids the institution in funding expansion, in addition to remaining competitive, while replenishing and raising capital. A rating of one (1) implies that current and projected earnings are sufficient to fully provide for loss absorption and capital formation with due deliberation to asset quality, growth and trends in earnings. In the case whereby earnings are positive, relatively stable and adequate in view of asset quality and operating risks, that credit union may receive a rating of two (2). Other factors such as earnings trends and quality must also be considered in assigning a two (2) rating. A rating of three (3) should be accorded if current and projected earnings are not fully sufficient to provide for the absorption of losses and the formation of capital to meet and maintain compliance with regulatory requirements. Inconsistent earnings trends, chronically insufficient earnings and less than satisfactory asset performance may also hinder the earnings of institutions. Further, earnings rated four (4) signals that there are erratic fluctuations in net income, the development of a severe downward trend in income or a substantial drop in earnings from the previous period and projected earnings are expected to decline. Credit unions undergoing consistent losses should be rated a five (5), since such losses may represent a distinct threat to the credit union's solvency via the erosion of capital. It also suggests that these institutions are unprofitable to the point that capital will be depleted within twelve (12) months.

In reference to liquidity (L), a rating of one (1) denotes only modest exposure to balance sheet risk and that management has demonstrated it has the necessary controls, procedures and resources to effectively manage risks. In addition, liquidity contingency plans have been established and are expected to be effective in meeting unanticipated funding needs. The level of

earnings and capital provide substantial support for the degree of balance sheet risk. Further, a rating of two (2) is accorded if the risk exposure is reasonable, management's ability to identify, measure, monitor, control and report risk is adequate, and the credit union is able to meet its reasonably anticipated needs. Moreover, the level of earnings and capital must provide sufficient support for the degree of balance sheet risk undertaken. In situations where the risk exposure is substantial and management's ability to manage and control risk requires improvement, a rating of three (3) is bestowed. It is likely that liquidity is insufficient to meet expected operational needs, necessitating unplanned borrowing and may also be an indication that the credit union is not meeting its self-imposed risk limits or is failing to take timely action to bring performance back into compliance. Therefore, improvements would be needed to strengthen policies, procedures, or the organization understanding of balance sheet risks. Ratings of four (4) and five (5) suggest that the credit union showed unacceptably high exposure to risk and management does not demonstrate an acceptable capacity to measure and manage interest rate risk, or unacceptable liquidity positions exist. Under both ratings the level of liquidity cannot adequately meet demands for funds and hence, immediate action to lower interest rate exposure, increase liquidity and improve conditions is necessary. With a four (4) rating a significant deterioration in performance is likely, while with a rating of five (5) it is inevitable, since there is extreme risk exposure or liquidity position so critical as to constitute an imminent threat to the credit union's continued viability. Risk management practices are totally insufficient for the size, sophistication and level of balance sheet risk.

With regard to sensitivity to market risk (S), this is a complex and evolving measurement area, which was added by the Federal Reserve and the Option Clearing Corporation (OCC) in 1995, mainly to address interest rate risk, the sensitivity of all loans and deposits to relatively abrupt and unexpected shifts in interest rates. This is a forward looking approach, which involves examining various hypothetical future price and rate scenarios and subsequently modelling their effects.

3.3 PEARLS FRAMEWORK VERSUS CAMELS FRAMEWORK

Specifically, the PEARLS system includes a monitoring tool employing financial ratios, a ranking tool for comparing credit unions, a business planning tool to promote high performance and other features. For each component, a set of financial ratios is used in the evaluation of credit unions' performance. In addition, PEARLS quantitatively evaluates the financial structure of the balance sheet and places emphasis on growth rates, which ultimately limits the possibility of influencing the rating.

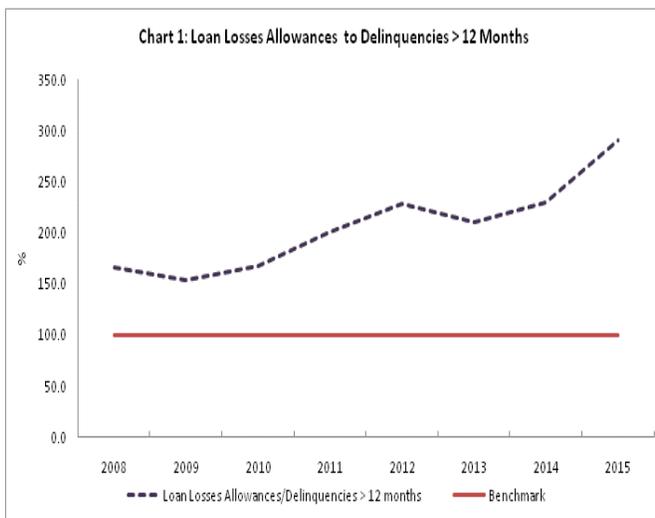
On the other hand, the CAMELS rating system is based on an evaluation of financial soundness indicators, which are the six (6) critical elements of a credit union's operations. The rating system is designed to take into account and reflect all significant financial and operational factors that examiners assess in their evaluation of a credit union's performance. The CAMELS framework which relies on the examiner's subjective opinions from observations is used to augment supervisory information not captured by purely quantitative measures.

In comparing the PEARLS and CAMELS framework, it was noted that the PEARLS system is ineffective in identifying and quantifying levels of risk, since it is benchmark based and allows

only for comparison of performance across credit unions. PEARLS uses largely quantitative information and no on-site examination is required. In contrast, CAMELS is an effective indicator of risk and financial soundness, since it focuses on the wider risk implications. It is a supervisory tool, which uses a mix of quantitative and qualitative information and requires on-site and off-site examination. Further, the M in CAMELS, which focuses on risk management, is what sets it apart from PEARLS.

SECTION 4: ANALYSIS OF PERFORMANCE INDICATORS IN THE BAHAMAS

In The Bahamas, similar to other Caribbean countries, credit unions play a pivotal role, as they are the second largest group of domestic deposit taking and loan granting institutions, offering a wide range of financial products and services to members. In the Caribbean region, the sector has been rapidly expanding, as evident in the broad-based expansion in their balance sheets. For The Bahamas, credit union assets, at end-2015 represented 4.2% of Gross Domestic Product (GDP) compared to 2.7% at end-2008, demonstrating its growing financial influence on the country's economic system. Therefore, credit unions in The Bahamas, as well as in the entire region, are being swept up in moves towards increased prudential supervision and oversight. As such, in 2015 the Central Bank of The Bahamas assumed full regulatory and supervisory oversight of credit unions in the country, so as to ensure that they are managed to international standards. Emphasis is on the safety and soundness of credit unions, making sure that they meet international standards.

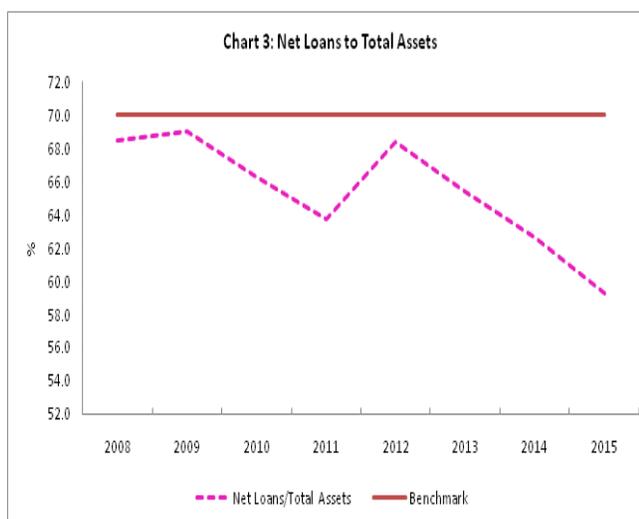
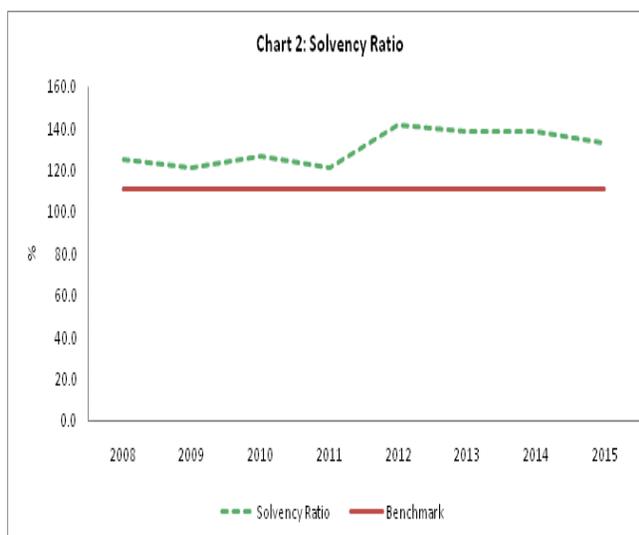


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Credit unions in The Bahamas, similar to their regional counterparts, are guided by the PEARLS system, which is used by regulators to monitor and evaluate their performance. The main goal of protection (P), which is to ensure that financial institutions provide depositors a safe place to save money, focused on the adequacy of the provisions for loan losses against the amount of delinquent loans. According to PEARLS international benchmark, provisions for loan losses from loans that are more than 12 months delinquent is 100%. Specific to The Bahamas, examination of this yardstick ratio revealed that for the period of study (2008-2015), credit unions have over the years exceeded the requirement (see Chart 1). For 2008, the loan losses allowances for delinquencies greater than 12 months ratio stood at 166.1%, and reflective of a rise in provisioning, the ratio surged to 291.3% at end-2015. This is an indication that that credit unions are setting aside earnings to cover those possible losses and that member-client savings are being protected. Further, under protection there is the solvency ratio, which measures the relative worth of one dollar in member-client savings after adjusting for known and possible losses. The solvency ratio is computed by dividing the net value of assets by total shares and deposits. Based on the international PEARLS benchmark, this ratio should be greater than or

equal to 111%, which credit unions in the country have been in compliance with throughout the review period. In 2008, the solvency ratio stood at 125.3%, firming to 132.7% in 2015, thus, suggesting that the cash flow of credit unions in The Bahamas is sufficient to meet both short-term and long-term liabilities (see Table 3 & Chart 2).

The financial structure of the credit union is the most important factor in determining growth potential, earnings capacity and the general strength of the sector. In examining the ratios under effective financial structures (E), the international target for net loans to total assets is between 70%-80%, signalling the amount of the sector's assets that are financed with loans. Over the past eight (8) years, this ratio recorded an annual average of 65.4%. In 2008 to ratio was 68.5%, narrowing to 59.3% in 2015 (see Table 3 & Chart 3). Although below the benchmark ratio, the results indicate that credit unions' total assets are still largely financed via their loan portfolio, thus maximizing returns on these productive assets, while providing their member-clients with the credit services they require.



Further, liquid investment to total assets is another standard by which credit unions effective financial structure is measured. A liquid investment is one that can be easily converted to cash, either through the ability to buy or sell the investment or the ability to access or withdraw funds. According to PEARLS international goal, the liquid investment to total assets ratio should not exceed 16%. For the review period, 2008-2015, credit unions in The Bahamas, for the most part were in compliance, only slightly exceeding the 16% target ratio once, in 2011, when it reached 16.9%. In 2008, the liquid investment to total assets ratio was 9.4%, declining to 3.7% in 2015 (see Table 3). The annual average over the eight (8) years period was 7.8%. The result showed that the sector has sufficient reserves of cash and securities that can be readily converted to cash, to meet its obligations if funding is interrupted.

Financial investments are assets that you invest in with the expectation that they will grow and yield a larger sum of money. Such investments are in the form of Government bonds, stock, shares in other companies and the League. However, based on the PEARLS prudential standards, investment in such assets should not exceed 2.0%, owing to the risk associated with such

investments. However, for The Bahamas, this ratio was slightly above the target, averaging 3.2% per annum over the period 2008-2015. This perhaps is due to the fact that these investments offer competitive rates of return and they are less risky, which was evident in 2012 when this ratio peaked at 4.5%. With the decline in savings and fixed deposit interest rates, the interest rates offered on Bahamas Government registered stock are the highest in the country, thus making it a more lucrative investment. Hence, as shown in Table 3, the financial investment to total assets ratio increased from 2.4% in 2008 to 3.9% in 2015.

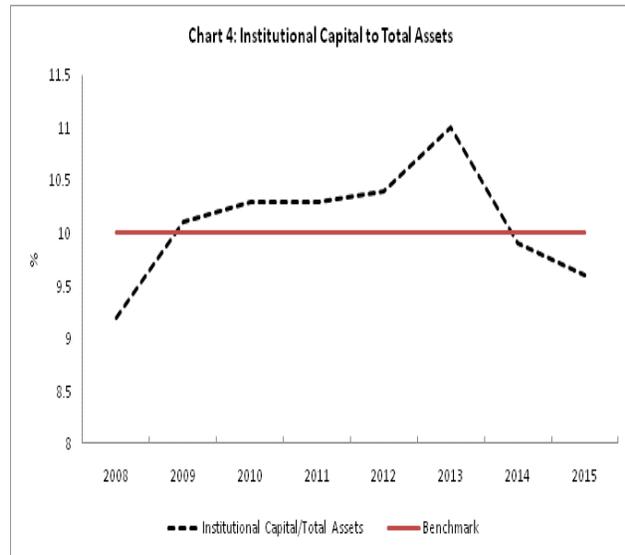
In terms of the fixed assets to total assets indicators, the benchmark ratio is a maximum of 5% for credit unions, according to PEARLS minimum standards. Fixed assets are viewed as unproductive assets, given the accumulated depreciation cost related to these assets, attributed to wear and tear. Therefore, these assets will have to eventually be replaced, hence requiring a significant amount of investment capital. For credit unions in the country, the fixed assets-to-total assets ratio was in accordance with the international maximum 5% requirement, averaging an annual 3.6% over the past eight (8) years. The ratio trended downwards to 3.7% in 2015 from 4.1% in 2008 (see Table 3).

Credit unions are said to have an effective financial structure when assets, financed by savings deposits, generate sufficient income to pay market rates on savings, cover operating costs and maintain capital adequacy. In the savings-led credit union movement, where demand for loans is met via savings mobilization, the ratio of savings deposits-to-total assets is pegged at a prudential 70%-80%. For credit unions in The Bahamas, this ratio hovers just above 50%, its highest rate of 54.2% was in 2008, before declining to 43.1% in 2015 (see Table 3). Nevertheless, an analysis of members' savings deposits revealed that there was a moderation (2.4%) in growth and a subsequent falloff (1.1%) in savings in 2008 and 2009, respectively—the height of the global economic downturn. However, in line with the domestic economic recovery, albeit at a mild pace, the growth in savings rebounded, advancing by 9.1% in 2015. Hence, despite being below the benchmark ratio, indications are that credit unions are still able to mobilize savings.

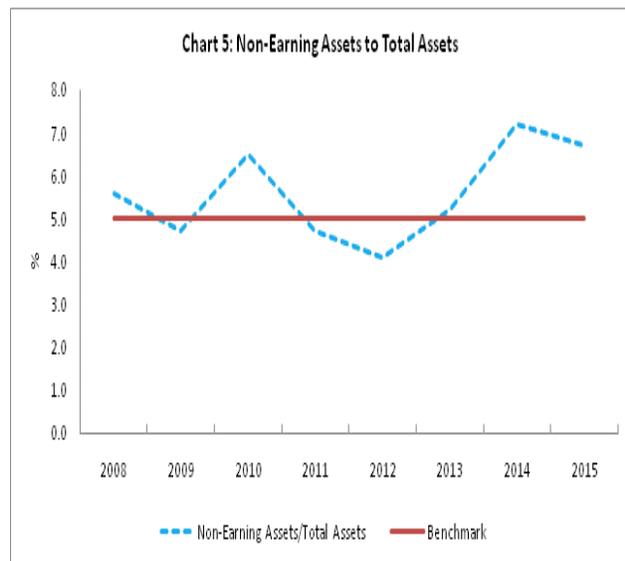
Further, credit unions are owned by its membership and hence, one component of its capital is shares, since members are required to purchase shares. The required membership shares varied from credit union to credit union. However, according to the PEARLS standards, the minimum prudential norm is that member share capital-to-total assets ratio should not exceed 20%, suggesting that this should not be a primary source, although an important one, for financing the sector's assets. Examination of the member share capital-to-total assets ratio for credit unions in The Bahamas showed that this ratio is at a minimum, as for the review period, the highest rate of 1.7% was in 2012, which was in line with the strong growth in share capital (34.0%) that occurred during that year.

Institutional capital, which consists of all legal reserves and surplus created from either the accumulation of net income or from capital donation, is the second line of defense to absorb unexpected losses and protect savings. Institutional capital is owned collectively by the membership, with no individual direct claim on the capital and as such, these reserves allow the credit union to support high return rates on savings, sustain low costs on loans, create additional reserves and invest in added services. Hence, in order to ensure capital adequacy, World Council recommends credit unions maintain a capital level of 10% of total assets. An analysis of The Bahamas credit unions institutional capital uncovered that they are in conformity with

international benchmarks, averaging 10.1% per annum during the review period (2008-2015). The ratio, which was 9.2% in 2008, trended upward over the years, exceeding the minimum standard at 11.0% in 2013, before narrowing to 9.6% in 2015 (see Table 3 & Chart 4). The results thus revealed that the sector is well capitalized and members' savings are protected.



Asset quality (A), which evaluates risk, controllability, adequacy of loan loss reserves and acceptable earnings, in addition to off-balance sheet earnings and loss, is a pivotal variable that affects institutional profitability. Credit unions' assets are adversely affected if there is an excess of defaulted or delayed repayment of loans and high percentages of other non-earning assets, since these assets failed to earn income. Therefore, credit unions are subject to regulatory capital requirements, since capital allow them to grow, establish and maintain both public and regulatory confidence, and provide a cushion, in the form of reserves, to absorb potential loan losses above and beyond identified problems. Further, as a test of capital strength, credit unions must be able to generate capital internally, via earnings retention. Hence, in assessing capital adequacy, there are a number of key indicators that are used to determine if solvency can be sustained.



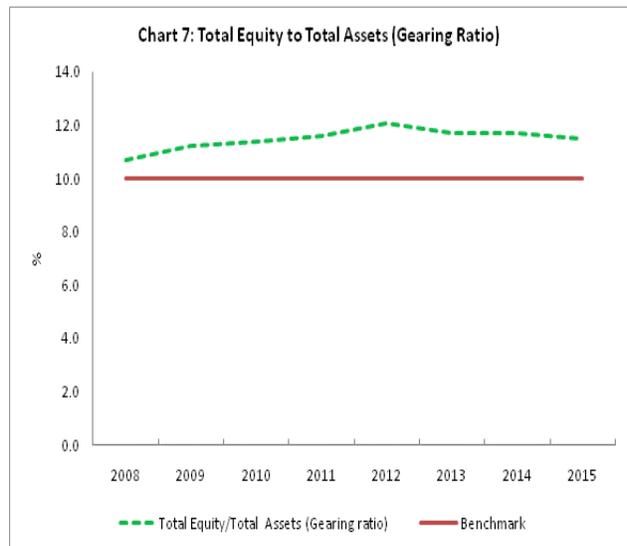
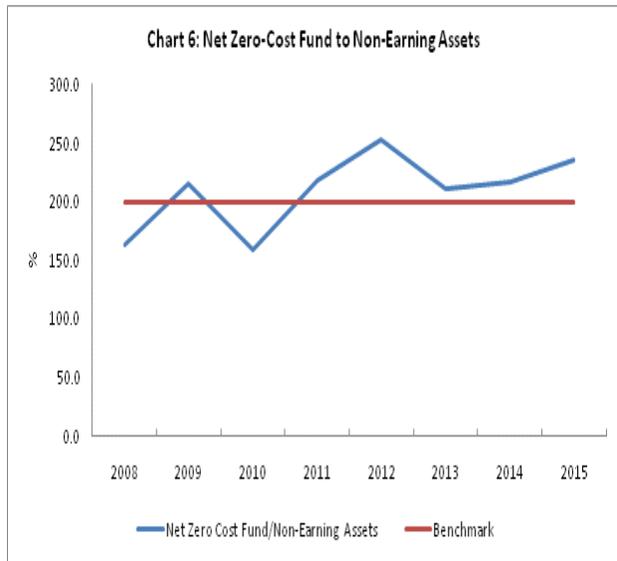
For instance, since it is essential that delinquency⁴ be measured correctly and minimized, the total loan delinquency-to-gross loan portfolio ratio is utilized by the PEARLS monitoring system. This ratio, which is a measurement of institutional weakness, is benchmarked at a maximum of 5%, because if delinquencies are excessively high, then it is an indication that other key areas of credit union operations could be weak, such as loan loss provisions, institutional capital and net income. For The Bahamas, in the absence of historical delinquencies data, the ratio of loan loss allowances to gross loans was analysed in assessing the quality of assets. Over the years 2008-2015, the ratio fluctuated within the range of 3.8% - 6.0%. The ratio was at its highest point of 6.0% in 2015, as the economy continues to grapple unprecedented levels of loan arrears, in an environment of subdued economic activity and elevated unemployment. The ratio was still relatively high, thus indicating that loan delinquency levels remained high.

⁴ Delinquency is the total outstanding balance of distressed loans greater than 30 days.

Furthermore, in assessing asset quality, the ratio of non-earning assets⁵ to total assets was analysed over the past eight (8) years. Credit unions must monitor and limit non-earning assets to a maximum of 5.0% of total assets, and invest 95% of its funds in assets that earn a return. An examination of non-earning assets for credit unions in The Bahamas showed that during the eight years period, these assets almost doubled to \$17.2 million in 2015 from \$12.7 million in 2008. Consequently, the non-earning assets-to-total assets ratio averaged 5.6% per annum, which was slightly above the prudential norm of 5.0%; the rate was at its highest level of 7.2% in 2014, but decreased to 6.7% in 2015 (see Table 3 & Chart 5). Therefore, what this is inferring is that the sector is minimizing its investment in these non-earning assets and investing in more productive assets that will earn a return greater than the cost of funds and operating expenditures.

The only way to hold and stop non-earning assets, such as fixed assets from negatively affecting earnings is to finance all these non-productive assets with credit unions' no-cost capital, such as, institutional capital or reserves. As such, the PEARLS system recommends that credit unions maintain a net zero cost funds-to-non-earnings assets ratio level of 200% or greater. For the review years, the sector has been in compliance with the required standard, except for 2008 (163%) and 2010 (159.1%) when the ratio fell below 200% (see Table 3 & Chart 6). The ratio peaked in 2012, at a record level of 252.7%, but narrowed to 235.6% in 2015, although remaining above the international PEARLS benchmark.

Another indicator used to determine the adequacy of the sector's capital stock is the gearing ratio, which is the total equity-to-total assets ratio. The equity to assets ratio is a measure of the solvency of the sector, as it assesses its ability to meet obligations and absorb unexpected losses. According to international standards, the ratio should be 10% or greater in order for credit unions to be classified as well capitalized. An investigation of the gearing ratio revealed that in The Bahamas, the sector is well capitalized, with the total equity-to-total assets (gearing) ratio exceeding the benchmark level, with an annual average ratio of 11.5% over the last eight (8) years. The ratio have been trending upwards over the years, moving from 10.7% in 2008 to 11.5% in 2015; the ratio was at its

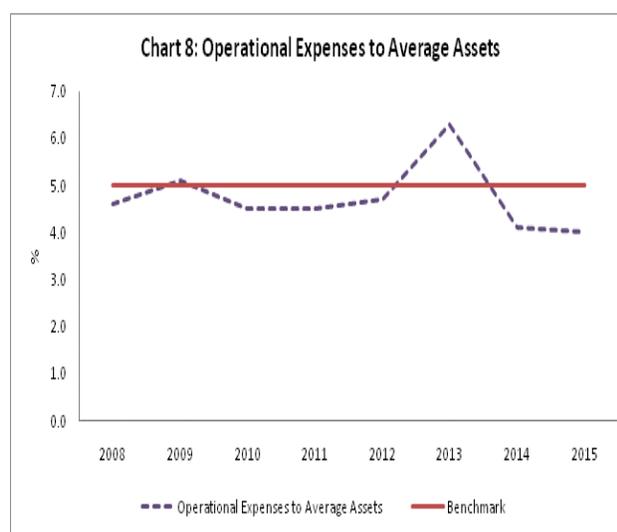


⁵ Non-earning assets comprise of the holdings of land, buildings, vehicles, furniture and cash.

highest point in 2012, when it posted a rate of 12.1% (see Chart 7). The upward trajectory of this ratio suggests that most of the sector’s capital continues to originate from shareholders and hence it is likely that it is not burdened with heavy debt. Further, it implies that the sector can meet all its current and future obligations.

Rates of return and costs (R) indicators monitor the returns earned on each type of asset (use of funds) and the cost of each type of liability (source of funds). In particular, on the asset side, the types of assets that earn the highest returns can be determined, while on the liability side, the least and most expensive sources of funds can be decided. In this category, operational costs, including financial costs paid on deposit savings, share-savings and external loans are measured. Under rates of return and costs, the income ratios identify income from net loans, liquid assets, financial investments and non-financial investments. Meanwhile, the financial cost ratios examine the costs of savings deposits, external credit and dividends on shares. The operating expense ratios disaggregate operating costs and provisions for risky assets. In comparing expenses to assets, this ratio highlights the notion that a larger balance sheet gives rise to higher operations that requires more resources.

More specifically, the operating expenses-to-average assets ratio, which reflects both the operating efficiency and the operating strategy of a credit union, is benchmarked at 5.0%. For credit unions in The Bahamas, the ratio was in line with its target over the 2008-2015 period, averaging 5.0% per annum. The operating expenses-to-average assets ratio ranged between 4.1% and 6.3% over the review period. The ratio was above the prudential requirement in 2013, when it peaked at 6.3% (see Table 3 and Chart 8). Thus, revealing that the percentage of assets used for operations are within the 5.0% target.

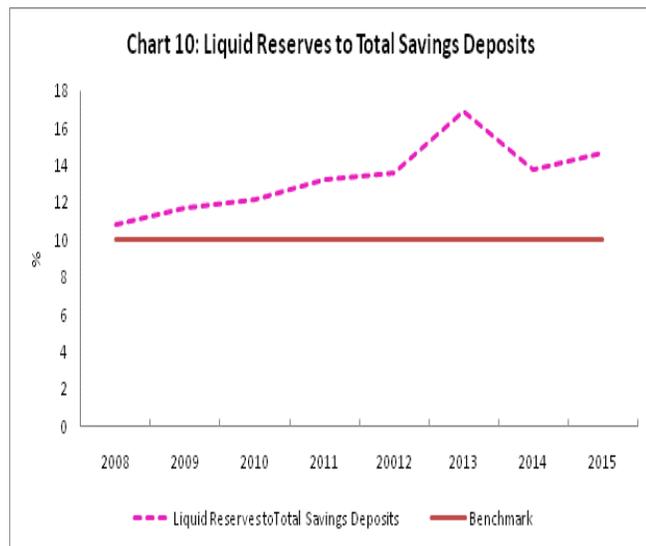
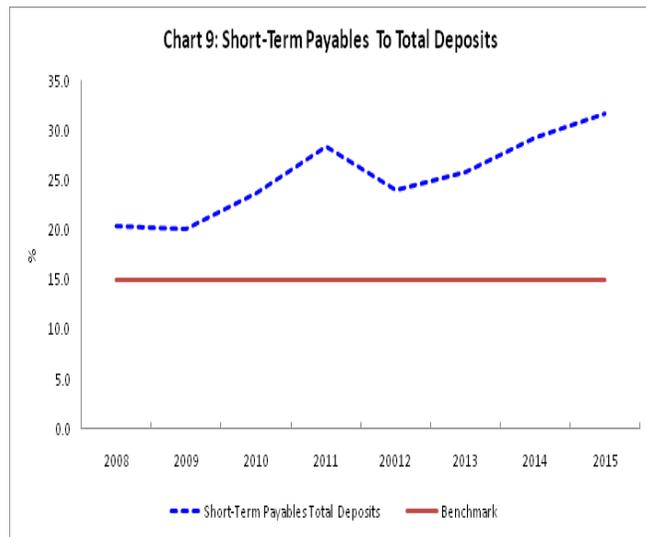


In terms of the other income-to-average assets ratio, according to prudential norm this should be kept at a minimum, since it relates to receipts from activities other than normal business operations. Credit unions in The Bahamas were able to maintain this ratio at a minimum during the review years, averaging an annual 1.2% over 2008-2015. As shown in Table 3, the ratio recorded its highest point of 1.7% in 2012 and the lowest was 0.9% in 2015.

With regard to the net income-to-total assets ratio, commonly referred to as return on assets (ROA), this is an indicator of how profitable the credit union is relative to its total assets. The net income-to-total assets ratio (ROA) gives an idea as to how efficient management is at using its assets to generate earnings. Based on the PEARLS framework, the ratio should be enough to reach the goal for institutional capital. From 2008 to 2015, the sector’s net income-to-total assets profitability ratio trended upwards, advancing by 0.9 percentage points to 2.1% in 2013 from 1.2% in 2008, indicating that earnings are being generated from invested assets. However, growth in the net income-to-total assets ratio slowed to 0.3% in 2015, its lowest point, as domestic economic activity remained subdued.

The gross margin-to-average assets ratio reflects the efficiency of the total investment and therefore shows how efficient the sector is in investing its assets into profitable ventures. The PEARLS system advocates that the prudential norm is that this indicator to be sufficient to meet the goal for institutional capital. A review of this indicator revealed that for most of the reviewed years this ratio has been increasing for the credit union sector in The Bahamas, with the exception of 2010 and 2011, when the ratio narrowed, reflective of the adverse effects of the global recession. The ratio, which stood at 4.8% in 2008, rose to 7.9% in 2013; but decreased to its lowest level of 3.4% in 2015. Hence, given the upward movement in this ratio for the majority of years, it is reasonable to state that the sector was efficient in its investments.

Moreover, managing liquidity (L) is essential to overseeing any savings institution, since one need to know the amount of cash and similar to cash resources, that can easily be converted to cash, typically within one year. Thus, liquidity is basically the amount of capital that is available for investment and spending. It also refers to the ability to convert assets into cash quickly and without any price discounts. One indicator used by the PEARLS framework to monitor liquidity includes the short-term payables to total deposits ratio. This ratio serves to ensure that short-term investment is liquid enough to respond to member-client withdrawals and disbursement demands. The international benchmark for this ratio is 15%-20%, and for The Bahamas the credit union sector was well above this target, averaging 25.5% over the last eight (8) years. The ratio increased from 20.4% in 2008 to 31.8% in 2015, its highest rate (see Table 3 & Chart 9). Therefore, these high ratios are an indication that the sector is holding robust levels of liquidity and can easily and quickly obtain cash to support its day to day operations. However, one downside to the elevated ratio is that although buoyant liquidity produces flexibility for an investor, it also reduces profitability.



Similar to banks, credit unions are required to hold a portion of their deposits as reserves and, according to prudential standard, the liquidity reserves fund should be equal to 10% of total savings deposits. Hence, the liquidity reserves-to-total savings deposits ratio should not be lower than 10%. In The Bahamas, for the eight (8) year period (2008-2015), the ratio was in

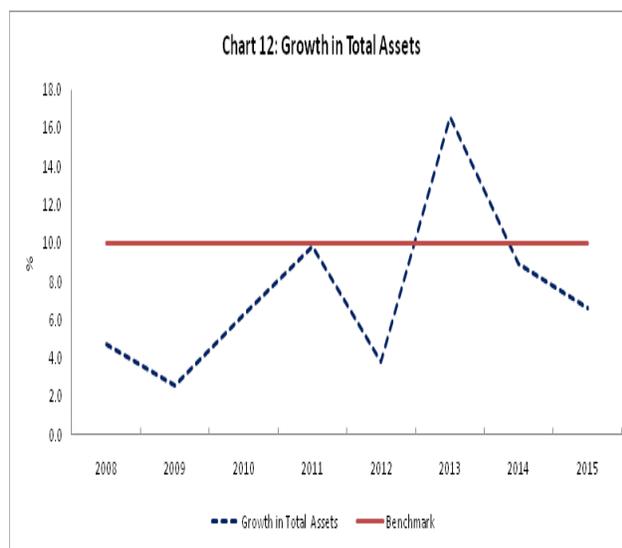
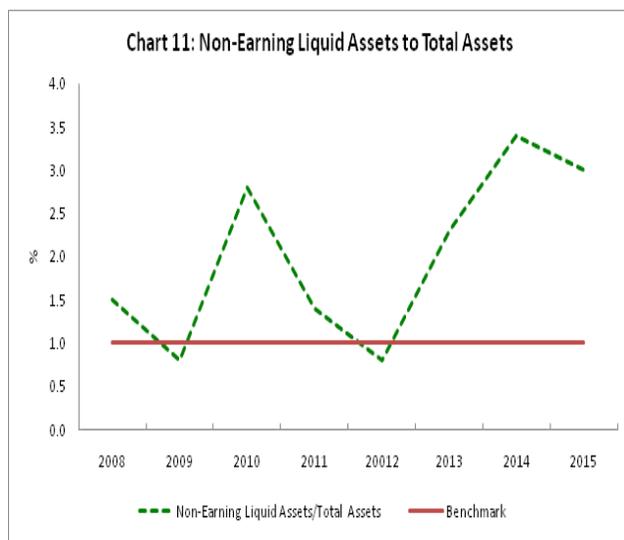
compliance with the suggested yardstick, fluctuating within a range of 10.8% and 14.7% (see Table 3 & Chart 10); thus indicating credit unions are in line with statutory requirements.

In terms of non-earning liquid assets—which are assets that, by their very characteristics, do not generate interest income—the goal is to maintain these types of assets to less than 1.0% of total assets and to minimize them to most daily operational needs. In general, all financial institutions should aim to minimize such assets, which include cash, land, building, vehicles and furniture. For the domestic credit union sector, the non-earning liquid assets-to-total assets ratio was within the stipulated target in 2009 and 2012 at a rate of 0.8% each (see Chart 11). However, as shown in Table 3, the ratio exceeded the benchmark for most of the review years, peaking at 3.4% in 2014, albeit still remaining relatively low.

The final monitoring tool for PEARLS is the signs of growth (S) indicators, which can assist managers in maintaining a balanced and effective financial structure. Signs of growth signals member-client satisfaction, appropriateness of product offerings and financial strength. Moreover, growth directly affects an institution’s financial structure and requires close monitoring to sustain balance. For instance, an expansion in savings results in growth in total assets, but if loans are not growing as fast as savings, then the institution will have a build-up in liquidity and hence low earnings. Likewise, as savings are growing, then it is necessary to observe that institutional capital is rising at a similar pace so as to ensure that there is a buffer to protect those savings from unexpected losses.

In addition, growth in total assets is a critical indicator, since the majority of PEARLS performance indicators are related to assets. The prudential norm is for the annual increase in total assets to be 10% minimum, since the financial structure is directly affected by growth. Credit unions in The Bahamas were able to achieve this target in 2013, when expansion in assets grew by 16.6%, attributed to broad-based expansions in their balance sheet (see Chart 12).

Another performance indicator is liquid investments, which are those that can be readily converted to cash. Annually this indicator should not expand by more than 16% according to the international standard. For the respective years 2010, 2011 and 2015, the build-up in local credit unions’ liquid investments exceeded the stipulated goal, growing by a staggering 25.4% and



55.2% and 23.1%, buoyed by an accumulation in fixed deposits, which was perhaps due to a low interest rate environment, with fixed deposits offering a relatively higher rate, than ordinary savings. Nevertheless, in 2008, 2009 and 2014 liquid investments was within the required benchmark, with increases of 9.6%, 10.2% and 8.4%, respectively. In a turnaround, liquid investments declined by 77.2% in 2012, with a significant slowdown in the reduction to 1.5% in 2013.

With regard to an expansion in savings deposits, although remaining below the targeted 70%-80%, for the majority of the years under review (2008-2015), there was growth in savings, the highest being 14.4% in 2013. In 2009, in line with the contraction in the domestic economy, savings deposits declined by 1.1%, but recovered by a modest 1.9% in 2010 and strengthened further to 3.4% in 2011. However, in an environment of mild economic growth, savings deposits fell by 7.7%, before rebounding by 14.4% in 2013 (see Table 3), although moderating to 9.1% at end-2015.

In terms of institutional capital, in which the minimum prudential standard for growth is 10%, gains were recorded for the majority of the review years, although for some years the rate was below the target, with the exception of one year when a decline was registered. In 2014 institutional capital contracted by 4.2%, before recovering by 2.6% in 2015. Nevertheless, growth surged to 22.9% in 2013, its peak since 2008 (see Table 3). The results suggest that, although developments were mixed, the sector's reserves have been growing and hence, there are enough reserves to cover losses and support high return rates on savings, maintain low costs on loans, create additional reserves and invest in additional services.

Table 3: PEARLS PRUDENTIAL RATIOS									
	Benchmark	2008	2009	2010	2011	2012	2013	2014	2015
Protection									
Loan Losses Allowances/Delinquencies > 12 months	100%	166.1	154.0	168.2	200.9	228.6	210.8	229.8	291.3
Solvency Ratio (Net Value of Assets/Total Shares & Deposits)	> = 111%	125.3	120.9	127.1	120.9	142.0	138.6	138.4	132.7
Effective Financial Structure									
Net Loans/Total Assets	70-80%	68.5	69.0	66.3	63.7	71.4	69.3	66.4	63.5
Liquid Investments/Total Assets	< = 16%	9.4	10.1	12.0	16.9	3.7	3.1	3.2	3.7
Financial Investments/Total Assets	< = 2%	2.4	2.4	2.2	2.2	4.5	3.9	3.7	3.9
Fixed Assets/Total Assets	<= 5%	4.1	3.9	3.7	3.3	3.3	3.0	3.8	3.7
Savings Deposits/Total Assets	70-80%	54.2	52.2	50.1	47.2	41.9	41.1	42.1	43.1
Member Share Capital/Total Assets	<= 20%	1.5	1.2	1.1	1.3	1.7	0.7	0.7	1.1
Institutional Capital/Total Assets	> = 10%	9.2	10.1	10.3	10.3	10.4	11.0	9.9	9.6
Asset Quality									
Total Loan Delinquencies/Gross Loan Portfolio	< = 5%	n/a	8.7	7.7	10.2	n/a	11.9	13.4	12.9
Allow. for Loan Losses-to-Gross Loans		5.6	3.8	3.9	4.2	4.2	4.9	5.1	6.0
Non-Earning Assets/Total Assets	< = 5%	5.6	4.7	6.5	4.7	4.1	5.2	7.2	6.7
Total Equity ¹ /Total Assets (Gearing ratio)	> = 10%	10.7	11.2	11.4	11.6	12.1	11.7	11.7	11.5
Net Zero Cost Fund/Non-Earning Assets	> = 200%	163.0	216.0	159.1	218.5	252.7	210.6	217.4	235.6
Return on Equity		11.2	8.2	8.8	3.2	13.2	17.9	7.0	3.0
Liquid Assets to Total Assets		19.7	19.4	22.6	26.5	20.4	22.0	25.0	27.4
1/ Total Equity includes members' capital, institutional capital and the reserve fund									
Source: Department of Cooperative Development									

Table 3 Cont'd: PEARLS PRUDENTIAL RATIOS

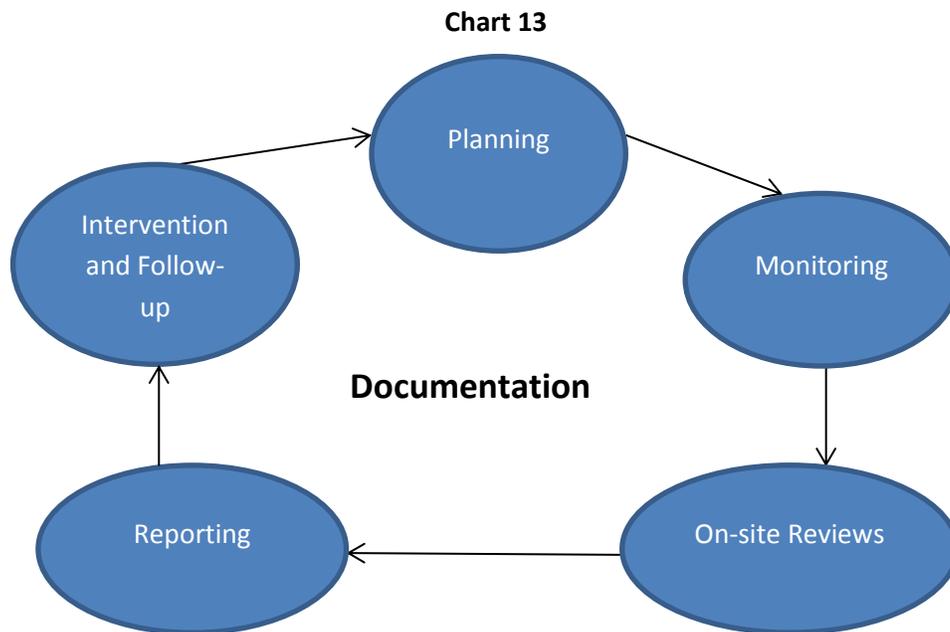
	Benchmark	2008	2009	2010	2011	2012	2013	2014	2015
RATES OF RETURN									
Operational Expenses/Average Assets	< = 5%	4.6	5.1	4.5	4.5	4.7	6.3	4.1	4.0
Gross Margin/Average Assets	Enough to meet the goal for Inst. Cap.	4.8	4.9	4.6	3.8	4.7	7.9	3.9	3.4
Other Income/Average Assets	Minimized	1.1	1.2	1.2	1.3	1.7	1.2	1.1	0.9
Net Income/Total Assets (ROA)	Enough to meet the goal for Inst. Cap.	1.2	0.9	1.0	0.4	1.6	2.1	0.8	0.3
LIQUIDITY									
(Liquid Asses-ST Payables)/Total Dep.	15-20%	20.4	20.1	23.7	28.4	24.1	25.8	29.3	31.8
Liquid Reserves/Total Savings Dep.	10%	10.8	11.7	12.2	13.2	13.6	16.9	13.8	14.7
Non-Earning Liquid Assets/Total Assets	<1%	1.5	0.8	2.8	1.4	0.8	2.3	3.4	3.0
SIGNS OF GROWTH									
Growth in Total Assets	> Infl. + 10%	4.7	2.6	6.3	9.8	3.8	16.6	8.9	6.6
Growth in Liquid Investments	10%	9.6	10.2	25.4	55.2	-77.2	-1.5	8.4	23.1
Growth in Savings Deposits	70%-80%	2.4	-1.1	1.9	3.4	-7.7	14.4	10.0	9.1
Growth in Institutional Capital	> = 10%	11.9	12.7	8.4	9.7	5.6	22.9	-4.2	2.6
<i>Source: Department of Cooperative Development</i>									

SECTION 5: POLICY RECOMMENDATIONS

Credit unions play an important role in The Bahamas' financial system in providing competition for the domestic banks in their provision of alternative financial services to their members. Therefore, although Bahamian credit unions differ from banks in being mutually owned, they should be subject to the same prudential regulations and supervision as banks, given their significance to the financial system, which has been increasing over the years. Both assets and membership has been on the uptrend.

Specifically, there is need for greater supervision in the sector, which would involve a dynamic assessment of the operations of credit unions, to ensure that they continue to operate in a safe and sound manner, and comply with their governing statutes and all supervisory requirements. Hence, bringing credit unions in The Bahamas under the supervisory and regulatory remit of the Central Bank was a step in the right direction. With prudent supervision there is likely to be closer integration of macro and micro prudential supervision, with focus on early detection of emerging risks so as to have timely intervention. Further, increased supervision will lead to enhanced evaluation of risk through separate assessments of inherent risks and risk management processes, giving rise to an in-depth understanding of credit unions' operations, their risk appetite and the main drivers of their risk profile. Heightened supervision will also result in early identification of credit unions with prudential issues and concerns.

The supervisory review process for the sector should involve planning, monitoring, on-site inspections, reporting, intervention and follow-up (see Chart 13).



In terms of planning, it is recommended that a supervisory strategy for the sector be developed, and if there is one, it should be updated. This should be executed in conjunction with the development of an annual supervisory plan. With regard to monitoring, a thorough review of credit unions' information should be conducted. In addition, a comparative analysis of the results of early ratios and the material changes in the industry, as well as its operating environment,

should be analysed to determine the possible impact of these changes on the institution's risk profile. Moreover, although the scope of monitoring depends on the size, complexity and risk profile of the individual credit union, it is recommended that each credit union be inspected at least quarterly. However, credit unions with higher risk should be scrutinized more frequently.

Another critical aspect of the supervisory process is on-site reviews, which is recommended for credit unions in The Bahamas. These reviews and interactions with the credit union management and oversight functions are critical to effective supervision of the sector and they also enhance the supervisor's understanding of the credit union and its risk profile. The knowledge acquired should also be documented and all future changes incorporated by updating the original documents, which would make the process more efficient.

Supervisors should prepare and disseminate a management report, at least annually, to credit unions to communicate their overall assessment of the institution's risk profile, and any prudential concerns identified, in addition to recommendations for addressing them. Once this has been done, in respect of follow-up, supervisors should ensure that a satisfactory response is received from the institution on a timely basis, and should include actions planned to address prudential reported issues. All material prudential concerns should be addressed on a timely basis before they impact the risk profile of the credit union.

Overall, although credit unions in The Bahamas have succeeded despite the recent global financial crisis, the difficulties encountered have called for heightened regulatory infrastructure in the system. Therefore, increased support from the Central Bank in the form of tighter control of local credit unions is necessary. The passing of the new Credit Union Act now administered by the Central Bank will enforce regulation of the financial activities of the sector.

SECTION 6: CONCLUSION

Credit unions in The Bahamas and globally are gaining increasing recognition as alternatives for banks, since they offer distinct strengths, including a non-profit orientation, in which members' interests have traditionally been the paramount focus. They provide relatively lower interest rates on loans, greater accessibility to loans and a more customized approach to their membership than their larger counterparts in the financial industry.

In this context, in June 2015, the credit union sector in The Bahamas was brought under the supervisory remit of the Central Bank. Hence, this first detailed study of the sector found that there are industry-specific tools for assessing the sector's viability and soundness. These are mainly the PEARLS monitoring system and CAMELS framework, which employ an analytical approach called ratio analysis and involves using the credit union financial statements to compute ratios. The ratios are used to compare the performance of the credit union with rules of thumb, past periods and industry averages.

Specifically, application of the PEARLS model to the domestic credit unions' consolidated data revealed that the sector is viable and in most instances, attained the goals that defined excellent performance for a credit union. In general, the sector is well capitalized, exceeding the minimum prudential norm of 10% and maintained adequate liquidity to meet their short-term obligations, exceeding the benchmark standard of 15%. The CAMELS framework also confirmed that credit

unions in The Bahamas are financially sound. However, reflective of the challenging domestic economic conditions, indications are that loan delinquencies trended upwards over the review years, signalling a rise in credit risks. Therefore, there is need for heightened supervision of credit unions in The Bahamas, with focus on risk-based supervision, which requires an understanding and assessment of risks in credit unions activities and an analysis of the quality of risk management and oversight of these institutions. As such, since assuming regulatory responsibility for the credit unions, the Central Bank commenced both on-site and off-site examination of the sector. Consideration is also being given to the introduction of a stress testing methodology so as to better assess the soundness of the credit union sector.

Based on the assessment, credit unions do not pose a threat to financial stability in The Bahamas. Nevertheless, credit unions' actions need to be understood in the context of the broader economic and industry environment, with the key levels of risk in their activities identified and addressed, so as to avoid systemic stress episodes.

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