CENTRAL BANK OF SOLOMON ISLANDS

FINANCIAL STABILITY REPORT

June 2021

The Financial Stability Report (FSR) is prepared by the Financial Systems Regulations Department (FSRD) of the Central Bank of Solomon Islands.

The report is published half yearly, and all enquiries pertaining to the FSR should be addressed to:

The Chief Manager
Financial Systems Regulations Department
Central Bank of Solomon Islands
P O Box 634
Honiara
Solomon Islands

Telephone: (677) 21791/21793

Facsimile: (677) 23513

SWIFT BIC: CBSISBSB

Email: info@cbsi.com.sb
Website: www.cbsi.com.sb

Follow Central Bank of Solomon Islands on:

Twitter: @cbsiinfo
Facbook: www.facebook.com/cbsiinfo

Note:
This report is available only on the Bank's website.

This report is based on unaudited and provisional data of banks and non-bank financial institutions available up to June 30th, 2021 unless stated otherwise in the relevant chapters/sections.

TABLE OF CONTENTS

APPENDICES

Pages

LIST OF CHARTS

LIST OF TABLES

Abbreviations

CBSI refers to Central Bank of Solomon Islands
2H20 refers to second half of 2020, which ended 31st December 2020
1H21 refers to first half of 2021, which ended 30th June 2021

FCOPR	Foreign currency open position ratio
FSI's	Financial soundness indicators
IMF	International Monetary Fund
NPLs	Non-Performing Loans
SINPF	Solomon Islands National Provident Fund
The Fund	refers to Solomon Islands National Provident Fund

Chapter 1: OVERVIEW OF INTERNATIONAL & DOMESTIC FINANCIAL CONDITIONS

Global economic recovery began to emerge in the first half of 2021 after the perennial stress caused by the COVID-19 pandemic; thanks to the unprecedented policy supports from both governments and central Banks around the world, which assisted in keeping the global economy afloat. According to the International Monetary Fund, the global economy was projected to recover firmly by 6 percent in 2021 (IMF) [1]. This is largely influenced by an upswing in fiscal support in advanced economies, which have helped in keeping bankruptcies, unemployment rates and economic impairments at bay. More so, the fast pace of COVID-19 vaccination roll outs that also assisted in relaxation of movement restrictions underpinned a reboot of economic activities. In addition, governments and central banks around the globe have also been providing accommodative fiscal and monetary policy stances since the start of the pandemic all through to the first half of 2021. These stimulus measures have supported economic recoveries and contributed to stable financial conditions. However, such unprecedented policy actions, if not handled properly, may rekindle some financial vulnerabilities that would potentially unveil unforeseen consequences like inflation in the medium term.

Towards the end of 1H2021 and into the third quarter of 2021, the picture has started to change. Global economic growth for 2021 was revised downward by 0.1 percentage points to 5.9% (IMF World Economic Outlook, Oct 2021). This outcome was mainly attributed to supply chain disruptions in advanced economies and the resurgence of the covid-19 variant in the emerging and developing economies[2] . However, on the financial side, global financial stability has been contained so far and banks have been resilient against financial shocks mainly due to the level of capital buffers accumulated over the years prior to the pandemic. But, concerns regarding the resurgence of virus mutations and uncertainty surrounding the strength of the economic recovery surfaced. Long-term yield price persistently increases unanticipatedly. This will put pressure on asset prices and thus elevate risk to inflation. Such, may potentially result in tight financial conditions that will affect capital flows and further fuel debt build-up in frontier markets. Notwithstanding this, albeit uneven, credit outlook has been steady and most firm had been able to repair their balance sheets. Yet, financial vulnerabilities remained high in number of sectors and thence, may potentially jeopardise growth in the medium terms if they interact with a sudden repricing of risk as a result of an uncontrolled inflation. Hence, heading on, should there be persistent increase in prices; a tight monetary condition is imminent to mitigate the inflationary pressure on the economy.

The April 2021 IMF's Financial Stability Report identified two emerging themes that would cumulate risk to future financial stability. First, the road to economic recovery is expected to be asynchronous and divergent across economies, but more particularly between the advanced and emerging economies. As a result, the emerging economies' risk of exposure to tight financial conditions could be elevated if advanced economies take steps towards normalization of policies. Such policy normalization may cultivate an unfavourable financial environment and induce large portfolio outflows, posing significant financial challenges to some emerging and frontier markets, especially during such time of large financial need. Inevitably, countries that have weak macroeconomic fundamentals, limited access to Covid-19 vaccines, and high vaccine hesitancy ratio are likely to be affected the most. Second, the unprecedented policy support undertaken by most economies, which are aimed fundamentally at cushioning the global economy from further scaring from the pandemic, may have unintended consequences. These unintended consequences may include the amplification of valuation and financial stability risks that could invent a new structural legacy problem for some economies going forward.

On the domestic front, the Solomon Islands economy is estimated to grow by 0.4 percent in 2021, down from the initial projected growth of 1.5 percent[3] . This downward revision to real GDP growth largely reflected the prolonged impact of COVID-19 pandemic, border restrictions and weaker-than-expected performances across broad sectors of the economy. Output for most primary commodities such as palm oil, cocoa and round logs have declined, negating the increase in production output of fish, copra and coconut oil.

As a result of weak performances in the real sector of the economy, government finances came under considerable strain amidst weak revenue collections and heightened expenditure pressures associated with Covid-19 containment measures. This has restricted the government's ability to provide the much-needed fiscal stimulus to support growth and settle its domestic creditors on time. The contracting government revenue indeed have negative consequences on the financial sector as continuous delays on payments to its contractual service providers, landlords particularly those with mortgages; this in turn flare non-performing loans (NPL), putting pressure on banks' and credit institutions' capital. This, if not managed properly would potentially elevate solvency drains, and going forward – might proliferates solvency issues that would put financial system stability at risk.

Despite the weak performance of the economy, the Solomon Islands financial sector performed reasonably well in the first half of 2021. This was due in part by the unprecedented policy supports and regulatory forbearance by the Central Bank of Solomon Islands (CBSI), along with efforts undertaken by each Licensed Financial Institutions (LFIs) to ensure that financial risks remain cornered. The year-

1 Obtained from the International Monetary Fund (IMF) World Economic Outlook, July 2021 Update

2 Obtained from the International Monetary Fund (IMF) World Economic Outlook, October 2021 Update

3 Obtained from the CBSI Monetary Policy Statement, September 2021 MPS

long policy support undertaken by CBSI through relaxing some of the conditions in its Prudential Guidelines has so far not only helped to contain risk to financial stability, but also assisted banks and credit institutions in maintaining the flow of credit to businesses and households, which ultimately sustained economic activities. Further, the policy actions have been very supportive in relieving financial consumers from over indebtedness as a result of the pandemic induced financial hardship.

That aside, a recent preliminary review on the country's financial sector resilience undertaken by the Financial Systems Regulation Department of CBSI reaffirmed the resilience of the country's financial sector. The review suggested that the overall resilience of the country's financial sector was extremely satisfactory (See Appendix 4). This outcome was anchored on: (i) sufficient asset qualities; (ii) adequate capital positions; (iii) high liquidity levels: (iv) efficient business continuity plans; and (v) sufficient contingency planning. Thus, resonates the financial sector's ability in the short to medium term to mute, any financial shocks within the economy.

However, potential volatile conditions remain elevated as the country continued to brace against the potential importation of the covid19 delta variant. This along with the government's tight financial position will accelerate additional vulnerabilities for the domestic financial sector. Such vulnerabilities together with a prolonged economic downturn may put the country's financial sector resilience to test.

Nevertheless, the financial sector continues to maintain an uptrend movement in its total assets with the banking sector recording a soft rebound of 0.7 percent in 1H2021. Insurance sector maintained its growth momentum, posting $197.7 million in total asset cumulative to June 2021, compared to $168.1 million recorded in December 2020. Similarly, Superannuation's assets grew by 2.9 percent to $3,863.7 million while credit union sector edged upwards by 7.4 percent to $92.3 million.

Chapter 2: FINANCIAL SECTOR RESILIENCE

2.1 Banking Sector Resilience

The Banking Sector remained resilient and extremely satisfactory in 1H21, with capital adequacy ratio (CAR) reaching 33.4%, surpassing the regulatory capital requirement of 15%. This outcome came on the back of reductions in provision expenses together with non-interest expenses during 1H21, as shown by the positive return on assets ratio. Similarly, the sector's liquidity remained adequate with no sign of stress, as indicated by the deposit-to-loans and liquid assets-to-total assets ratios. Hence, the sector has more than adequate funds to meet short-term obligations as they fall due (See Table 1). The Sector maintained its normal operation throughout 1H21.

Table 1: Banking Sector Financial Soundness Indicators, 1H18 - 1H21

	1H18	2H18	1H19	2H19	1H20	2H20	1H21
Capital Adequacy							
Total regulatory capital-to-risk weighted assets ratio (RWAs) (CAR) >15%	32.9%	31.1%	28.9%	31.3%	29.2%	33.7%	33.4%
Tier 1 regulated capital to risk weighted assets ratio >7.5%	30.9%	30.0%	28.9%	30.8%	29.2%	31.5%	33.0%
Nonperforming loans (NPLs) net specific loan loss provisions-to-capital & reserves	10.9%	11.8%	18.3%	18.0%	20.2%	16.6%	18.1%
Asset Quality							
NPL-to-total gross loans ratio	5.8%	7.1%	9.8%	10.4%	11.8%	10.6%	11.4%
Specific loan loss provisions-to-NPLs (Coverage Ratio)	23.2%	30.9%	25.5%	29.4%	27.9%	29.9%	28.7%
Earnings & Profitability							
Return on Assets (ROA)	3.8%	3.5%	3.5%	3.1%	1.8%	2.1%	2.5%
Return on Equity (ROE)	21.8%	20.4%	21.4%	18.3%	10.0%	11.8%	13.4%
Net-interest Income to Gross Income	53.8%	54.6%	52.4%	53.6%	58.2%	59.1%	59.6%
Cost-to-income ratio	51.8%	52.1%	52.5%	54.0%	56.4%	57.1%	58.3%
Non-interest income-to-gross income	46.2%	45.4%	47.6%	46.4%	41.8%	40.9%	40.4%
Personnel expenses-to-noninterest expenses	31.4%	30.9%	30.2%	29.7%	32.2%	31.2%	34.4%
Interest spread	10.4%	10.0%	10.1%	9.6%	9.8%	9.2%	9.2%
Liquidity							
Deposits-to-loans ratio	145.7%	158.4%	148.2%	143.0%	148.8%	152.7%	147.8%
Liquid assets-to-total assets ratio	39.0%	40.4%	38.7%	37.4%	39.5%	45.4%	46.5%
Sensitivity to Market Risks							
Net open position in foreign exchange-to-capital <25%	3.5%	4.1%	2.2%	2.1%	7.4%	2.4%	2.4%

Source: *Central Bank of Solomon Islands*

2.2 Superannuation Sector Resilience

The superannuation sector[4] also remained strong in 1H21, despite border restrictions and uncertainties caused by the coronavirus (COVID-19) locally and globally. The resilience mirrors SINPF Board's robust leadership in ensuring necessary controls are in place to mitigate inherent risks of the sector. This welcoming effort has given rise to significant improvement in capital adequacy ratio, cost to income ratio and return on assets ratio (See Table 2). The reduction in cost to income ratio and increase in return on assets ratio were largely driven by rental income and dividend income following the successful refurbishment of Anthony Saru Building and gains from value of offshore and onshore equities.

4 Comprises of one superannuation which is Solomon Islands National Provident Fund

Table 2: Superannuation Sector Resilience

	1H18	2H18	1H19	2H19	1H20	2H20	1H21
Capital Adequacy							
Capital to total assets	11.9%	10.7%	18.8%	12.0%	12.3%	9.2%	11.9%
Asset Quality							
Substandard investment assets to total investment assets	2.3%	3.3%	3.5%	3.4%	3.2%	3.3%	3.3%
HHI (Exposure by Class)	2959.7	3040.3	3070.3	3056.1	2959.5	2919.1	2920.1
Earnings & Profitability							
Return on earning assets ratio	18.8%	11.6%	12.0%	7.9%	10.0%	6.1%%	15.3%
Cost to income ratio	16.2%	29.3%	11.1%	18.2%	74.7%	104.7%	23.0%
Return on assets ratio	5.7%	2.0%	18.2%	8.4%	0.0%	-0.6%	6.8%
Liquidity							
Liquid assets to total value of members contribution ratio	36.4%	30.2%	31.2%	27.7%	25.7%	24.9%	24.9%
Liquid assets to total assets ratio	30.9%	26.0%	24.4%	23.7%	21.7%	21.8%	21.8%

Source: *Central Bank of Solomon Islands*

2.3 Insurance Sector Resilience

Like other sectors of the financial system, the insurance sector was able to withstand adverse economic pressures imposed by COVID-19 that resulted in slow economic recovery in 1H21. The resilience of the sector was largely derived from strong capital, stable growth of underwriting business[5] and adequate liquid funds to settle its claims (See Table 3). In spite of the resilience, a further accumulation of its combined ratio could exert enormous pressure on the underlying profitability in 2H21.

Table 3: Insurance Sector Financial Soundness Indicators, 1H18 - 1H21

	1H18	2H18	1H19	2H19	1H20	2H20	1H21
Capital Adequacy							
Net Premium to Capital	47.0 %	33.4 %	41.6 %	37.4%	28.4 %	26.6 %	32.4 %
Capital & Reserves to Total Assets	38.6 %	41.2 %	46.2 %	46.6 %	42.3 %	47.4 %	42.2 %
Asset Quality							
Debtors to Total Assets	24.2 %	14.0 %	14.5 %	15.4%	21.5%	24.3%	23.5%
Debtors to (Gross Premium + Reinsurance)	81.5 %	57.5 %	53.9 %	57.3%	112.4%	158.8%	112.2%
Reinsurance & Actuarial Issues							
Risk Retention Ratio	67.8%	55.2%	73.0%	69.3%	72.4%	82.1%	67.6%
Adequacy of Claims							
Loss Ratio (Net Claims to Net Premiums)	19.2%	16.8%	5.2%	16.3%	30.9%	12.7%	17.5%
Earnings & Profitability							
Expense Ratio (Expense to Net Premium)	38.5%	55.3%	44.7%	44.5%	44.9%	35.9%	51.3%
Combined Ratio (Net Claims + Expense to Net Premiums)	57.7%	72.1%	49.9%	60.8%	75.8%	48.6%	68.8%
Investment Income Ratio (Investment Income to Net Premium)	1.2%	1.5%	1.2%	1.3%	-3.6%	1.7%	0.4%
Return on equity	18.6%	13.6%	20.0%	15.1%	5.4%	13.7%	7.5%
Liquidity Ratio							
Liquid Assets to Short Term Liabilities	142.3%	162.1%	177.7%	153.3%	146.5%	170.8%	184.8%

Source: *Central Bank of Solomon Islands*

5 Usually measured using growth in Gross Written Premium (GWP)

2.4 Credit Union Sector Resilience

Despite the ongoing uncertainties imposed by COVID-19 pandemic and its impact on the Solomon Islands Economy, the Credit Union Sector has so far shown notable improvement. The improvement is owed to the positive performance together with the level of adequate capital (See Table 4). The capital was above the threshold of 10 percent as reported. As required under the Credit Union Act 1986, the buffer is to protect against future losses and sustain credit union operations.

Table 4: Credit Union Sector Financial Soundness Indicators, 1H18 - 1H21

	1H18	2H18	1H19	2H19	1H20	2H20	1H21
Balance Sheet (SBD million)							
Total loans	46.1	47.8	50.3	50.7	52.6	55.8	56.5
Total Assets	71.5	70.7	85.1	79.8	81.5	84.9	92.3
Total Deposits (savings)	52.4	51.7	63.1	50.4	51.2	51.3	54.2
Total Share capital	14.9	15.3	18.4	26.1	26.1	27.7	31.9
Income Statement (SBD million)							
Income	2.9	3.6	4.4	4.5	2.9	4.2	3.8
Expenses	1.1	1.8	2.5	2.1	1.6	2.6	2.3
Net Surplus	1.8	1.8	1.9	2.4	1.5	1.6	1.5
Statistics							
Membership	6700	6700	6750	6790	6795	6800	6850
No. of Reporting Credit Unions	10	10	10	10	10	10	10
Indicators							
Capital Adequacy (>10%)	21%	22%	22%	33%	32%	33%	35%
ROA	2.5%	2.5%	2.2%	3.0%	1.8%	1.9%	1.6%
Loans to Assets	64.5%	67.6%	59.1%	63.5%	64.5%	65.7%	61.2%
ROE	12.1%	11.8%	10.3%	9.2%	5.7%	5.8%	4.7%
Self Sufficiency Ratio	263.6%	200.0%	176.0%	214.3%	181.3%	161.5%	165.2%

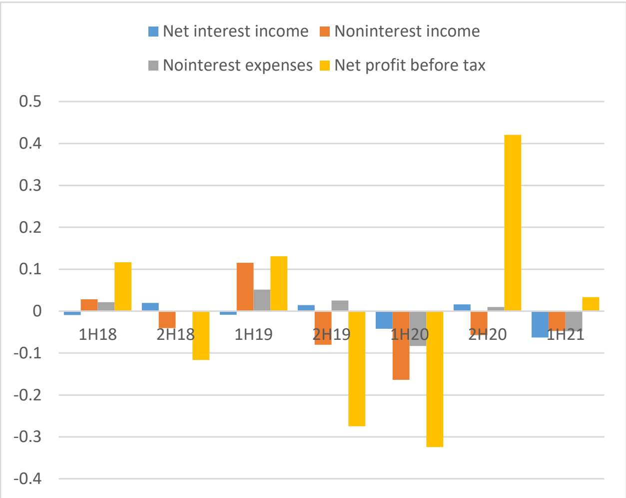
Source: *Central Bank of Solomon Islands*

Chapter 3: FINANCIAL SECTOR PERFORMANCE & DEVELOPMENTS

3.1 Banking Sector Performance

The Banking Sector remained profitable (Appendix 1.1) in the review period, despite the significant fall in net profit before tax (NPBT) growth from 42.1% in 2H20 to 3.3% in 1H21 (refer Fig.1). The sector's NPBT was driven down by a decline in both net interest, and noninterest income witnessed in 1H21. Nevertheless, profitability persisted given excess income from lending and gains on financial instruments that were able to cover operating expenses of the sector (See Fig. 1). Non-interest expenses also fell during the period mirroring changes in the Banking Sector's marketing and development strategies in pursuit of enhanced digital banking platforms.

Figure 1: Banking Sector half-year growth, 1H18 - 1H21

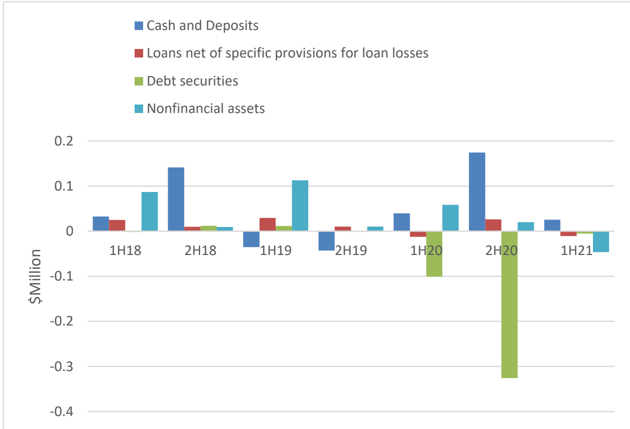


Source: Central Bank of Solomon Islands

At the back of slow economic recovery, total assets for banking sector remained relatively flat in 1H21. The slight increase from $6.36 billion in 2H20 to $6.39 billion in 1H21 was supported by positive movements in demand balances due from depository institutions resulted from inter-bank settlements (See Appendix 1.2). Drilling into core assets of the banking sector, they all decreased in 1H21 except the demand deposit balances (See Fig. 2).

Looking closely at the lending activities in 1H21, the slight fall in Loans and Advances (Net of Specific Loan Loss Provisions) underpinned the commitment of commercial banks to manage existing loan portfolios whilst they assess the prevailing situations for opportunities to provide additional loans to existing customers as well as new customers. Similarly, it also reflects the risk averse approach taken due to uncertainties associated with Covid-19. Meanwhile, 1H21 saw bulk of reductions for loans under construction, forestry and communication sectors. This was mainly due to usual loan amortisation against the decline in credit demand by customers and the banks' commitments to maintain quality loan portfolios. Meanwhile, personal loan and distribution sectors inched upward by 28.6% and 2.5% respectively as banks and credit institu-

Figure 2: Banking Sector half-year growth in assets, 1H18 - 1H21

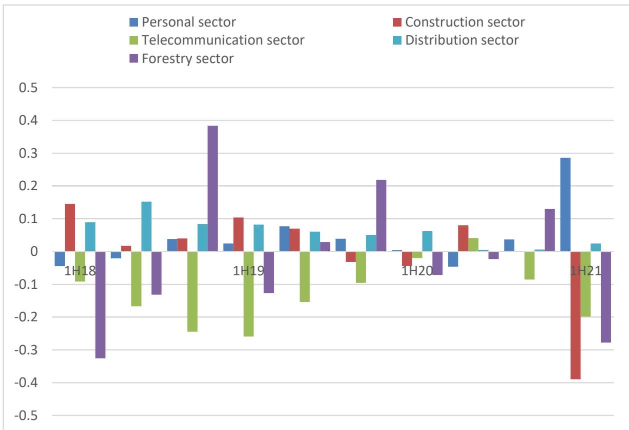


Source: Central Bank of Solomon Islands

tions maintained their appetite to lend to these sectors. However, the increase was insufficient to reverse the fall in the overall loans and advances.

On the funding front, the sector continued to maintain stable funding amid the slow economic recovery and susceptibility to the global pandemic. Demand deposits, continued to dominate the total funding portfolio, accounting for 77% of the funding portfolio, while capital & reserves and other liabilities made up the rest in 1H21. The accumulation of deposits was a result of undisrupted business operations in 1H21.

Figure 3: Banking Sector half-year growth in key loans and advances by sectors

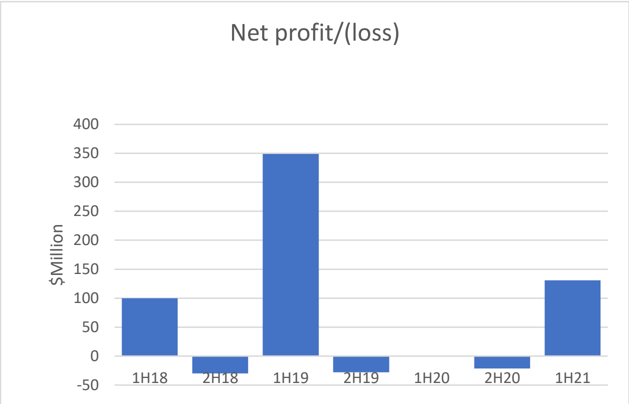


Source: Central Bank of Solomon Islands

3.2 Superannuation Sector Performance

Despite low economic recovery and presence of COVID-19 globally, 1H21 has seen an enormous improvement in the sector's performance from negative performance in 2H20 (see Fig. 4 & Appendix 2.1). The uplift was driven largely from growth in income from rental properties and dividend income from shares and equities, which saw a 479.2% growth in overall interest income.

Figure 4: Superannuation half year Net Profit

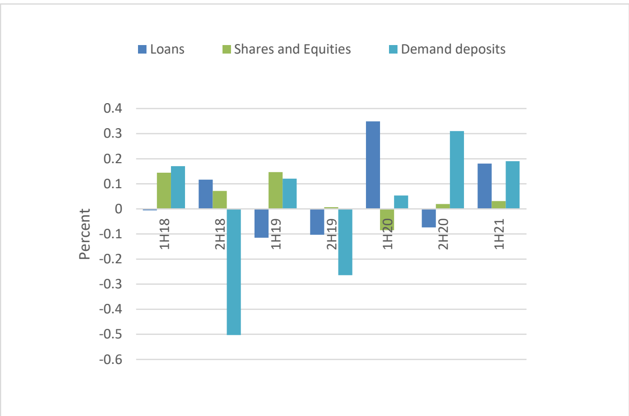


Source: Central Bank of Solomon Islands

Similarly, there was a slight increase in total assets of the Superannuation Sector. It grew 2.9 percent from 2H20 (See Appendix 2.2), reflecting the growth in the Fund's current account, time deposit, loans, and shares and equities.

The growth, especially in time deposits and loans, reflects the Fund's appetite to grow these portfolios to improve its income while the growth in current accounts reflects sustainability of receipt from its share & equities together with the inflows of members' contributions.

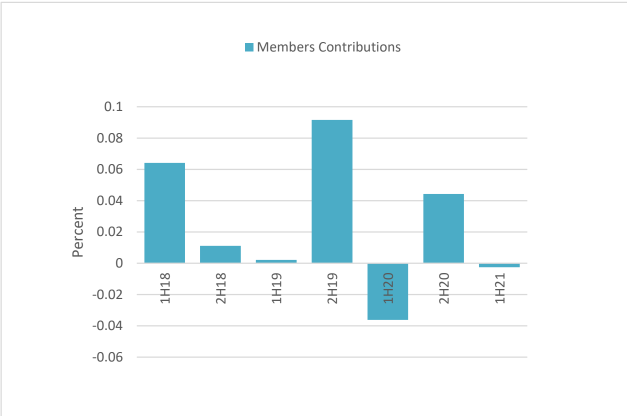
Figure 5: Superannuation sector growth in major assets



Source: Central Bank of Solomon Islands

The value of members contributions fell negligibly by negative 0.3 percent in 1H21 compared to 4.2 percent 2H20 (See Fig.6) despite a 1 percent growth in the number of formal members and 25 percent growth in youSave members. The negative growth was largely due to payments made to retiring members who turned 50 years and above in 1H21. Members who turned 55 years and above maintained a stable share of total membership portfolio since 2H20, accounting for 28.4 percent in 1H21.

Figure 6: Superannuation sector growth in Dollar value of Members Contributions



Source: Central Bank of Solomon Islands

Capital & reserves bounced back in 1H21 with 33.8 percent from 2H20 (See Annex 3.2). The welcoming growth was primarily due to improvement in profitability owing largely to rental income and dividend income.

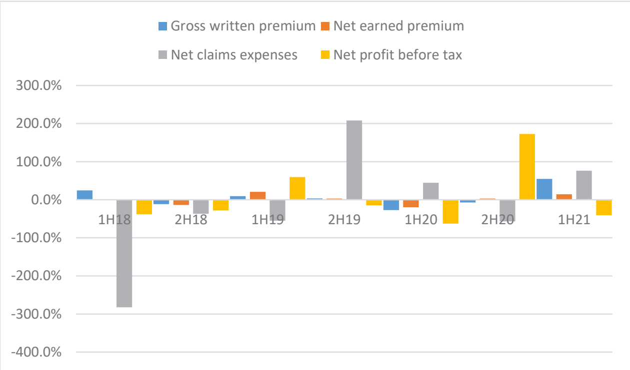
3.3 Insurance Sector Performance

Amid slow economic recovery and uncertainties on when coronavirus (COVID-19) might enter the country, the sector scored a reasonable profit in 1H21 (See Appendix 3.1). The enduring result was due to improvement in gross written premium despite the growth in net claims (See Fig. 7). The growth in gross written premium was largely driven by construction portfolio to which insurance sector provided cover for commercial risks.

Fire insurance continued to account for the bulk of the risks underwritten. It stood at $14.8 million in 1H21. This had emanated from the risk appetite that the local industry had to underwrite during the pandemonium, followed by the Motor vehicle Class, which recorded $6.1 million. Worker's Compensation (WOC) was the third largest contributor in the underwriting pool, recording $5.4 million while the remaining balance represented other classes of business, Householders, Construction All Risk, Liabilities, Marine and All Others respectively.

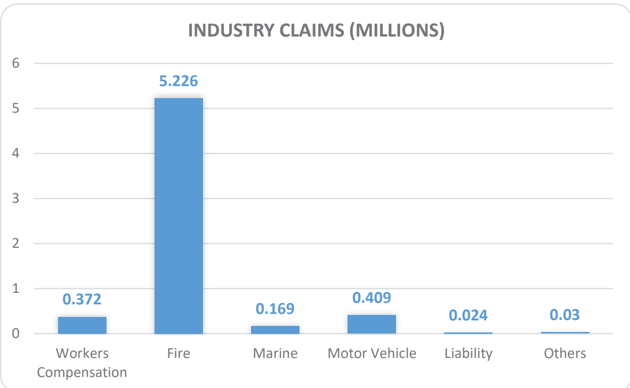
With regard to claims expenses, it was triggered by a significant movement in CAT[6] losses for the period. The increase was prompted by fire perils recorded for the period. In terms of the gross claims recorded by the industry, majority of the losses were concentrated in the commercial space with fire claims registering the peak losses compared to other classes (See Fig. 8).

Figure 7: Insurance sector half year growth in key components of income statement, 1H18 - 1H21



Source: Central Bank of Solomon Islands

Figure 8: Insurance sector Gross Claims by Class 1H21

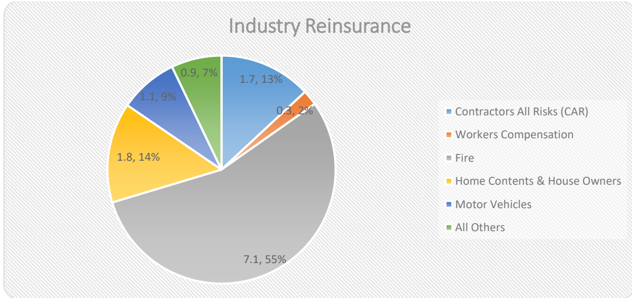


Source: Central Bank of Solomon Islands

In line with Gross Premium underwritten for the period, reinsurance ceded offshore to reinsurers intensifies in the first half of 2021. Reinsurance portfolio continued to complement the industry's risk appetite, with gross reinsurance for the period amounted to $12.9 million in 1H21 compared to $4.6 million in 2H20. The sector's reinsurance continued to provide buffer for the overall risk undertaken by the industry, albeit a decline in recoveries. This was bolstered mainly by the high-risk premiums in the fire class underwritten for the period. Fire class continues to lead the reinsurance portfolio (See Fig. 9). The retention ratio for this period still indicates efficiency of the industry, backed by on-going confidence from policyholders to insurers.

6 Catastrophic Losses – Huge losses in such a magnitude that is difficult to predict

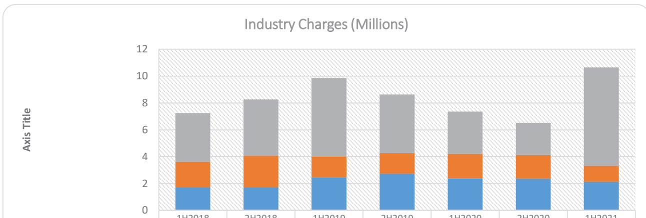
Figure 9: Insurance sector Reinsurance by Class



Source: Central Bank of Solomon Islands

In light of the sector's efforts to recover from the slowdown in underwriting business for the previous period, the industry continued to face substantial increase in its operating expenditures (underwriting and non-underwriting) for 1H21. This was prompted by the sectors heavy reliance on the support provided by their Head Offices (HO). Major costs incurred by the insurers were notable in Head Offices Charges, Other Underwriting Expenses, and Operational Management Expenses. 1H21 saw a significant surge in operational management expense compared to 2H20 (See Fig. 10). The outcome was due to the increase in (HO) support services as well as insurers taking more vigilant strategies to offload technical functions to HO which is said to subsequently improved insurers underwriting focus and customer service delivery.

Figure 10: Insurance sector Industry Charges



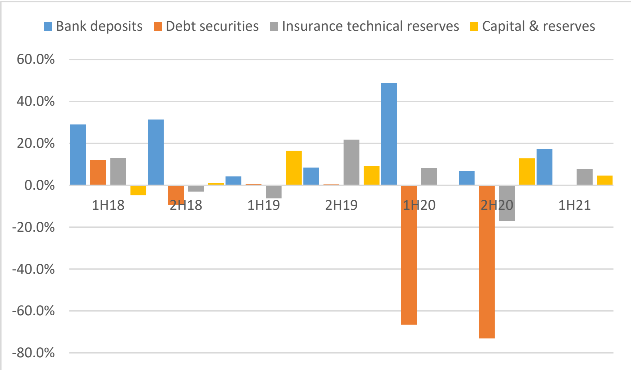
	1H2018	2H2018	1H2019	2H2019	1H2020	2H2020	1H2021
Operating Management Exp	3.626	4.189	5.856	4.373	3.153	2.398	7.327
Other Underwriting Exp	1.922	2.376	1.554	1.541	1.831	1.765	1.186
Branch Charges (HO)	1.692	1.692	2.449	2.718	2.378	2.356	2.127

Source: Central Bank of Solomon Islands

Whilst the industry tussles to recuperate in its performance, investments in financial assets continued to support the sector's financial investment base. The sector's consolidated balance sheet assets continued to grow in 1H21 (See Appendix 3.2). The growth in assets was largely due to an expansion in deposits held with commercial banks (See Appendix 3.2).

Conversely, the sector's total liabilities surged by 29% for the period. The increase in liabilities was notable in technical reserves accounts (See Fig. 11). The key contributor to technical reserves was apparent in unearned premium which composed of $34.5 million, $25.2 million in outstanding claims liabilities and $16.8 million in reinsurance contracts. Besides, total capital of the industry grew by 5 percent from 2H20. This was ascribed from 6 percent aggregate retain earnings boost from 2H20, a 21 percent expansion from 1H20 respectively.

Figure 11: Insurance sector half year growth in key assets and liabilities



Source: Central Bank of Solomon Islands

Albeit the COVID-19 pandemic, which has been the central focus for most of the financial sector, a number of developments also emerged during 1H21. At the start of the year, the insurance sector experienced liquidity and funding setback which forced a broker to voluntary liquidate and another to have its licence not renewed by the Office of the Controller of Insurance (OCOI). Despite of the instability affecting the sector and reduction in insurance intermediaries, the office (OCOI) have received expressions of interest from potential brokers to enter the insurance market.

In line with the current market changes in the sector, the insurance sector had remained up-beat to revamp its risk management strategies. Insurers have been innovative to restructure their market line through proposals for digital platform and repackaging of insurance policies to meet the market demand that are not explored before. This partly contributes to the sector's desire to remain resilient by formulating such innovative measures to curb the adverse impact of the current pandemonium. Notably, OCOI also observed that there remains a huge gap in the deepening of the insurance sector. This may also require continuous capacity building through technical trainings to assist participants in the market to raise their standard of insurance service.

In addition to the challenges, the progress of reform work to the insurance supervisory framework and amendment to the legal framework for the sector has been at a very slow pace. Therefore, to propel any developments, the sector needs an inclusive financial system to drive the development of essential products within general, life, and micro insurance particularly to meet rural sector and individual consumer demand.

3.4 Credit Union Sector Performance

Despite the challenges of 2020, the Credit Union Sector recorded a net income of $1.5 million. The satisfactory performance stemmed from growth in loan quality and interest earned on deposits with domestic financial institutions, which subsequently boosted capital and strengthened the sector's balance sheet (See Table 4).

Chapter 4: KEY VULNERABILITIES & RISKS TO THE FINANCIAL STABILITY IN THE SOLOMON ISLANDS

4.1 Banking Sector Vulnerabilities & Risks

The containment measures to combat entry of COVID-19 by the Government saw improvement in Risks Ratings for Credit, Liquidity and Cyber Risks (See Table 5). The low ratings also reflected efforts of Board and management of commercial banks in ensuring management and staff received their complete COVID-19 vaccination.

Similarly, operational risk has been downgraded to low given there was no mass outsourcing or offshoring of operations to third parties. The Banking Sector continued to operate and manage their material activities in 1H21 (See Table 5).

4.2 Superannuation Sector Vulnerabilities & Risks

1H21 witnessed a few vulnerabilities which are due largely to limited local investment opportunities, slow economic recovery and Covid-19 travel restrictions and uncertainties (See table 6). Credit concentration and default risks remained high due to lending to and ownership of Solomon Telekom Company Limited (STCL). STCL loans to total loans ratio jumped to 50.24 percent in 1H21 from 38.5 percent in 2H20 as a result of the conversion of dividend payable into new additional loans. The restructure is necessary given the existing financial situation that the company is facing during these unprecedented times.

While other shares and equities pumped in revenue for the Fund, investment risk remained high given the slow economic recovery. Credit risk and market risk pertaining to deterioration in rental payments and volatility in prices of shares and equities improved significantly to a Low Rating in 1H21.

4.3 Insurance Sector Vulnerabilities & Risks

The unprecedented economic environment brought about a number of key vulnerabilities for the local insurance landscape. Large part of the vulnerabilities stemmed from financial uncertainty as the industry remain susceptible to the COVID-19 pandemonium. In spite of the pandemonium anxiety, claims emanating from CAT losses remained minimal for 1H21. However, continuous changing weather pattern could potentially destabilize the sector's underlying business performance for 2H21. Together with the sector's continuous gravity in operational risk, the heightened operational expense could surge momentarily exerting pressure to the overall sector's performance. On the other hand, the pacing technological environment also piles onto the growing vulnerabilities for the sector given its constantly rapid evolution. These vulnerabilities brought about a broad range of risk if left unaddressed and can slowly erode the stability of the sector (See table 7).

4.4 Credit Union Sector Vulnerabilities & Risks

Like the Banking Sector, the Credit Union Sector is vulnerable to COVID-19 induced economic risk. However, the sector's governance, credit and liquidity risks remained low in 1H21 as credit unions maintain measures to weather the potential impacts of an economic fallout related to the COVID-19 pandemic. The Office of the Registrar for Credit Unions responded in two broad ways by, firstly, revitalising the Solomon Islands Credit Union League to ensure closer monitoring of credit union operations. Secondly, taking measures to encourage Credit Unions' Board of Directors, supervisory and credit committees to review their risk mitigation strategy and framework, and ensure they remain strong, effective and relevant for the current pandemic situation.

Table 5: Banking Sector Key Vulnerabilities and Risks

Vulnerabilities	Risk	Risk Description	2H20 Rating	1H21 Rating
Presence of COVID-19 pandemic globally and uncertainties of COVID-19 entering the country	Credit	Substantial default by borrowers	High	Low
	Liquidity	Deposits with uncertain maturity concentration	Medium	Low
	Cybersecurity risk	Failure of protect hackers from accessing core banking systems	Low	Low
Environment and market condition	Operational	Increase in cost of operation	Medium	Low

Source: *Central Bank of Solomon Islands*

Table 6: Superannuation Sector Key Vulnerabilities and Risks

Vulnerabilities	Risk	Risk Description	2H20 Risk Indicator	1H21 Risk Indicator
Limited local investment environment	Credit concentration risk	Deterioration in quality of single equity and borrower	Medium	Medium
	Default risk	Deterioration in quality of subsidiary loan portfolio	Low	Medium
COVID -19 travel restrictions and uncertainties	Credit risk	Deterioration in rental payments	Medium	Low
Slow economic recovery	Investment risk	Deterioration in returns from equity investments in price of domestic equities	Medium	Medium
Movements in global markets	Market risk	Volatility in price of onshore and offshore equities	Moderate	Low

Source: *Central Bank of Solomon Islands*

Table 7: Insurance Sector Key Vulnerabilities and Risks

Vulnerabilities	Risk	Risk Description	2H20 Rating	1H21 Rating
Build-up of debtors from instalment payments from insured.	Credit Risk	Delay in premium instalment repayments from policy holders can cumulate debt and deteriorate sector's asset quality	Low	Low
Under-pricing of risks within the insurance sector, induced by COVID-19 economic pressures.	Liquidity Risk	Undercutting of premium rates (discounts given) can occur between insurers to protect market share and has potential to lead to liquidity and solvency issues for the sector because of very small market.	Low	Low
Cyber-attack within growing local industry's digital landscape.	Cybersecurity	Storing of information and online transactions using cloud computing puts sector at risk of data loss and manipulation	Moderate	Moderate
Broad range of risk arising from changing weather pattern.	Liquidity	Continuous changing weather pattern can lead to large CAT losses that could severely impact insurers underlying profitability and liquidity		Moderate

Source: *Central Bank of Solomon Islands*

APPENDICES

Appendix 1 - Banking Sector

Appendix 1.1 Banking Sector Half Year Income Statement ($Million)							
	1H18	2H18	1H19	2H19	1H20	2H20	1H21
Net interest income	120.8	123.1	122.0	123.8	118.6	120.6	113.0
Noninterest income	103.6	99.4	110.9	102.0	85.3	80.4	76.6
Noninterest expenses	116.3	116.3	122.3	125.4	115.0	116.1	110.6
Provision expenses	(0.8)	10.1	1.9	21.5	35.6	9.1	0.7
Net profit before tax	108.8	96.1	108.7	78.9	53.3	75.8	78.3

Appendix 1.2 – Banking Sector Half Year Balance Sheet ($Million)							
	1H18	2H18	1H19	2H19	1H20	2H20	1H21
Cash and deposits	2,382.3	2,718.8	2,623.2	2,510.7	2,610.2	3,065.7	3,143.1
Loans net of specific provisions for loan losses	2,360.3	2,383.5	2,454.1	2,479.1	2,447.9	2,511.7	2,484.8
Debt securities	764.8	773.8	782.9	782.1	703.1	474.1	471.5
Nonfinancial assets	176.5	178.1	198.2	200.2	212.0	216.2	206.1
Total Assets	**5,756.4**	**6,131.8**	**6,144.0**	**6,070.2**	**6,083.3**	**6,367.9**	**6,397.5**
Currency and deposits	4,624.0	4,926.5	4,880.8	4,790.8	4,772.5	4,939.0	5,012.6
Other Liabilities	154.9	191.3	259.7	234.6	245.8	265.1	234.5
Capital and reserves	977.5	1,014.1	1,003.5	1,044.8	1,065.0	1,163.9	1,150.4
Total Liabilities & Capital	**5,756.4**	**6,131.8**	**6,144.0**	**6,070.2**	**6,083.3**	**6,367.9**	**6,397.5**

AAppendix 1.3 Half yearly Loans and advances by key sectors ($Million)							
	1H18	2H18	1H19	2H19	1H20	2H20	1H21
Construction sector	444.7	443.8	489.9	494.2	472.5	525.4	320.5
Forestry sector	50.7	60.3	52.7	75.5	70.4	103.5	74.7
Telecommunication sector	148.7	133.0	98.5	83.0	81.3	80.2	64.3
Personal sector	613.8	620.3	635.6	695.2	698.0	676.5	690.4
Distribution sector	463.4	495.9	536.7	558.4	593.1	588.6	603.1

Appendix 2: Superannuation Sector

Appendix 2.1 Half Year Profit and Loss Statement of Superannuation sector ($Million)							
	1H18	2H18	1H19	2H19	1H20	2H20	1H21
Interest income	119.0	40.1	167.9	30.8	150.8	29.8	121.5
Noninterest income	173.5	1.8	248.0	15.6	-90.9	-10.9	52.0
Noninterest expenses	47.5	50.5	46.3	37.7	44.9	37.8	40.0
Provisions	11.9	0.0	0.0	0.0	0.0	0.0	0.0
Interest payable	133.3	33.3	20.7	36.6	15.2	2.4	2.7
Net surplus/(Deficit)	99.9	-30.0	348.9	-28.0	-0.0	-21.3	130.8

Appendix 2.2 Half Year Balance Sheet Statement of Superannuation Sector ($ Million)							
	1H18	2H18	1H19	2H19	1H20	2H20	1H21
Demand deposits	386.8	192.3	215.5	158.6	167.0	218.9	260.6
Time deposits	690.2	711.1	721.8	747.4	642.6	600.9	601.3
Loans	126.0	140.6	124.5	111.6	150.6	139.5	164.7
Debt securities	197.2	206.6	218.9	228.0	264.3	251.1	257.1
Shares and equities	1541.4	1651.4	1894.1	1907.0	1745.2	1779.8	1835.9
Accrued interest & dividend receivables	28.7	31.0	25.6	13.7	39.3	39.4	11.1
Non-financial assets	483.8	500.6	608.9	631.5	680.5	692.1	698.6
Other assets	32.1	34.5	31.6	32.0	44.5	34.3	34.4
Total assets	**3486.0**	**3468.1**	**3468.1**	**3829.9**	**3734.1**	**3756.0**	**3863.7**
Members contributions	2959.2	2992.0	2998.4	3272.9	3154.6	3294.2	3285.7
Other Liabilities	108.3	103.5	120.0	98.6	119.9	118	117.3
Capital & reserves	416.3	372.6	722.6	458.3	459.6	343.8	460.2
Total liabilities & capital	**3486.0**	**3468.1**	**3556.3**	**3829.9**	**3734.1**	**3756.0**	**3863.7**

Source: *Central Bank of Solomon Islands*

Appendix 3: Insurance Sector

Appendix 3.1 Half year Income Statement ($Million)							
	1H18	2H18	1H19	2H19	1H20	2H20	1H21
1. Gross Written Premium	37.9	33.5	36.7	38.0	27.7	25.8	39.9
2. Outward reinsurance	12.2	15.0	9.9	11.7	7.6	4.6	12.9
3. Premium net of reinsurance (= 1 - 2)	25.7	18.5	26.8	26.3	20.1	21.2	27.0
4. Unearned premium reserves	1.0	-2.9	1.1	-0.1	-1.3	-0.8	1.8
5. Net earned premium (= 3 - 4)	24.7	21.4	25.7	26.5	21.3	22.0	25.1
6. Gross claims expense	9.1	2.4	2.2	6.9	10.5	2.6	6.2
7. Total recoveries	4.2	-0.7	0.8	2.6	4.3	0.0	1.5
8. Net claims expenses (= 6 - 7)	4.9	3.1	1.4	4.3	6.2	2.7	4.7
9. Acquisition Costs	-0.1	0.1	-0.1	0.1	0.2	0.2	-0.1
10.Total underwriting expenses	11.0	10.1	8.2	12.3	13.7	9.6	11.8
11. Underwriting Results (= 5 - 10)	13.8	11.3	17.5	14.2	7.7	12.3	13.3
12. Investment income on assets backing insurance liabilities	0.3	0.3	0.3	0.3	-0.7	0.4	0.1
13. Insurance Results (= 11 + 12)	14.1	11.6	17.8	14.6	6.9	12.7	13.4
14. Other operating expenses or management expenses	**3.6**	**4.2**	**5.9**	**4.4**	**3.2**	**2.4**	**7.3**
15. Net Profit (Loss) Before Tax (= 13 - 14)	**10.4**	**7.5**	**12.0**	**10.2**	**3.8**	**10.3**	**6.1**
16. Income tax or provisions	**3.2**	**2.9**	**3.7**	**3.4**	**1.1**	**3.0**	**1.6**
17. Net Income (Loss) End of Current Period (=15 - 16)	**7.3**	**4.6**	**8.3**	**6.8**	**2.7**	**7.3**	**4.5**

Source: *Central Bank of Solomon Islands, Restated*

Appendix 3.2 Half-year Balance Sheet ($Million)							
	1H18	2H18	1H19	2H19	1H20	2H20	1H21
18. Total Assets (= 19 + 20)	141.7	138.5	145.8	157.0	167.5	168.1	197.7
19. Nonfinancial assets	5.5	2.1	2.1	4.5	4.1	4.4	6.0
20. Financial assets (= 21 to 25)	136.2	136.5	143.7	152.5	163.3	163.7	191.6
21. Currency and deposits	49.5	65.0	67.8	73.5	109.4	116.9	137.1
22. Loans	-	-	-	-	-	-	-
23. Debt securities	52.1	47.3	47.6	47.8	16.0	4.3	4.3
24. Insurance technical reserves	34.3	23.2	26.3	29.1	36.5	40.9	46.5
25. Other assets	0.3	0.9	2.0	2.0	1.5	1.6	3.7
26. Liabilities (= 27+ 28)	81.2	83.2	81.4	86.6	96.9	88.5	114.3
27. Insurance technical reserves	71.4	69.3	65.0	79.2	85.6	71.0	76.5
28. Other liabilities	9.8	13.9	16.4	7.4	11.3	17.5	37.8
29. Capital and reserves	54.7	55.3	64.5	70.4	70.6	79.6	83.3
30. Balance Sheet Total (= 26+ 29 = 18)	135.9	138.5	145.8	157.0	167.5	168.1	197.7

Source: CBSI, Restated
Notes:
1) *Insurance technical reserves on the asset side include premium receivables, deferred reinsurance expenses, deferred acquisition costs, and other recoverable*
2) *Insurance technical reserves on the liabilities side include commission payables, unearned premiums and outstanding claims*

Appendix 4: Resilience Assessment and Explanations

Extremely unsatisfactory	Total weakness and does not meet minimal expectations. Deficiencies compounded to level that is beyond control. Lack of ability to withstand shocks and recover in long term.
Unsatisfactory	Weak and does not meet moderate expectations. Evidence of deficiencies exist and is not easily managed in the medium to long term. Weak ability to withstand shocks and recover in medium to long term.
Fair	Inadequate and might not meet full expectations with evidence of deficiencies but can be easily managed in the short to medium term. Limited ability to withstand shocks but may recover in short to medium term.
Satisfactory	Adequate and meets expectations and persist to maintain same trend in the short and medium term. Deficiencies are very minimal. Adequate ability to withstand shocks and recover in short to medium.
Extremely Satisfactory	Highly adequate. Above expectations and persist to maintain same trend in the short, medium, and long term. Absence of material deficiencies. Strong ability to withstand shocks and recover in the short term.

Source: Central Bank of Solomon Islands

Appendix 5: Vulnerabilities and Risks Assessment of Individual Sector

The rates reflect the probability (likelihood that an event will occur) and the impact (magnitude of the potential loss) that could stem from the event.

Low	Implies generally immaterial risk with little threat to financial stability of the sector
Moderate	Refers to minimal risk build-up that do not yet pose a threat to financial stability of the sector
Elevated	Refers to micro-financial conditions which signal high levels of risk build up that suggest the need for closer monitoring but not an immediate policy response for the sector
High	Indicates potentially disruptive levels of risk to the point where policy intervention should be seriously contemplated for the sector
Very High	Denotes that materialization of risk is imminent with a significant threat to the financial condition of the sector which requires immediate policy intervention.

Source: Central Bank of Solomon Islands