CENTRAL BANK OF SOLOMON ISLANDS

Financial Stability Report

JUNE 2020

This Financial Stability Report (FSR) is prepared by the Financial System Regulation Department (FSRD) of the Central Bank of Solomon Islands (CBSI)

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CHAPTER 1: OVERVIEW OF INTERNATIONAL AND DOMESTIC FINANCIAL ENVIRONMENT

The Coronavirus 2019 (COVID-19) pandemic significantly disrupted economic activity in the first half of 2020 when the world was put on great lockdown in the first and second quarters of the year. According to the International Monetary Fund (IMF)[1], global growth is projected to contract sharply by 4.9 percent in 2020, a downgrade of 1.9 percentage points from the April 2020 World Economic Outlook (WEO) forecast. Moreover, advanced and emerging market economies alike are projected for the first time since the Great Depression to decline markedly by minus 8.0 percent and minus 3.0 percent respectively.

Global economic recovery will be unevenly distributed and may take longer than expected. In addition, the path to recovery is uncertain as it is dependent on the extent and magnitude of the virus. As such risks to financial systems will remain heightened for some time.

Despite this collapse in real activity globally, financial conditions rebounded[2] after tightening sharply early in the year. This easing was driven mainly by the swift and unprecedented policy support by major Central Banks across the globe during the start of the pandemic. As a result of this extremely accommodative monetary policy support, a disconnect has been created between real outcomes and financial markets raising significant concerns of excessive risk taking and greater volatility in financial markets.

The June 2020 IMF's *Financial Stability Report* identified four key financial vulnerabilities or consequences that are evident in such unprecedented easing monetary policy support. First, high levels of debt could become unmanageable in severe economic contractions for some borrowers, increasing the risk of a broader impact on the solvency of companies and households. Second, the losses resulting from insolvencies could test banks' resilience as loan losses rise. Third, non-bank financial institutions are vulnerable to procyclical corrections amid any large market and credit losses amplifying the slowdown in economic and portfolio activities. Finally, economies face refinancing risks that are subject to be rolled over at much higher costs, especially if these economies already have low levels of reserve adequacy.

Against this weak background, the Solomon Islands economy is estimated to contract by 3.9 percent in 2020 due to the impact of COVID-19. As stated in the September 2020 *CBSI Monetary Policy Statement*, the first six months to June 2020 saw domestic economic activities declining drastically with broad falls in production, tourism, and construction, resulting in rising unemployment.

Domestic financial conditions across the first half of the year were resilient despite the disruptions in the financial markets that occurred at the beginning of the year. Key financial system performance indicators such as capital adequacy, profitability, liquidity and asset quality remain adequate, albeit at much lower levels than the pre-pandemic levels. Stress test results suggests that banks are able to absorb losses associated with a hypothetical downturn however, any prolonged downturn could put the banks' resilience to test. Nevertheless, pandemic induced vulnerabilities exist in the financial system amidst heightened uncertainty of COVID-19. Moreover, concentration risk, credit risk, liquidity risk and high non-performing loans remained risks to financial stability.

During the first six months of 2020, the banking sector recorded a sharp decline in overall net surplus to $35.4 million. The banks' total assets took another drop to $6,057 million. In the insurance sector, a smaller net profit after tax of $2.7 million was recorded whilst total assets rose 10 percent to $166.9 million. Total assets in the credit union sector rose marginally by 2 percent to $81.5 million. In contrast, the superannuation sector's total assets dropped negligibly to $3.7 billion.

[1] Obtained from the International Monetary Fund (IMF) World Economic Outlook, June 2020 Update.

[2] Obtained from the International Monetary Fund (IMF) Financial Stability Report, June 2020.

CHAPTER 2: THE PERFORMANCE OF THE SI FINANCIAL SYSTEM

This first half yearly review of the Financial Stability Report assesses how the domestic financial system has fared in this pandemic. It discusses recent developments, identifies financial risks and vulnerabilities, and highlights actions and policy responses taken to prevent and mitigate these risks.

Domestic financial conditions remained stable at the end of June 2020 as financial, credit and non-banking institutions continue to deliver financial services with minimal disruptions. Nevertheless, the financial system remained exposed to pre and post COVID-19 induced vulnerabilities. Further acceleration of these vulnerabilities and risks could weaken certain sectors within the financial system. Hence it requires the attentiveness of policymakers and regulators to ensure appropriate policy actions are taken in a timely manner to minimise future losses and financial system instability.

2.1 Vulnerabilities

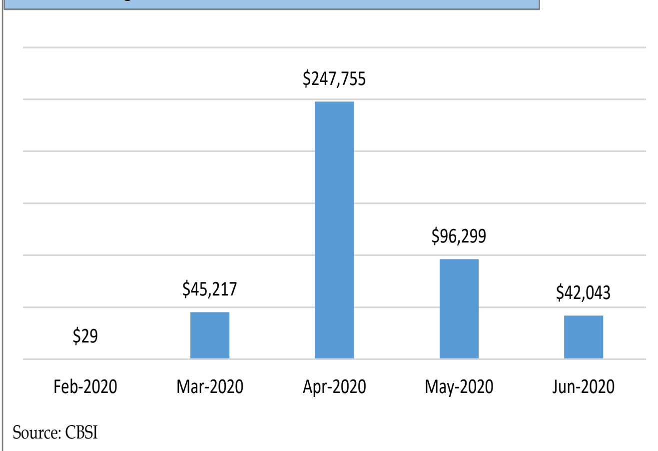
The Solomon Islands financial sector remained vulnerable to the impact of pre and post COVID-19. The effects of the pandemic have been felt and it is likely that the financial system could witness compounding effect towards the end of 2020.

Vulnerabilities arising from compounding non-performing assets or investments and losses due to impacts of COVID-19 remained a concern for domestic licensed financial institutions.

It is yet to be known but with the presence of the pandemic regionally and internationally, earning assets of banks, credit institutions, superannuation fund, and credit unions might not increase substantially, causing further threats to level of returns and capital of the sectors.

The pandemic could further increase the level of nonperforming loans (NPLs) and losses for the banking sector due to travel restrictions and business disruptions. Additionally, overall profitability of the banking sector could fall further through non-repayments of interests by borrowers and delays in asset recovery processes on problem loans. As shown in chart 2.1.1, principal and interest payments relating to a total of $448.1 million loans have been suspended by banks and credit institutions from February 2020 to the end of June 2020. The loan categories that had been significantly affected were personal, tourism, distribution and transportation sectors.

Chart 2.1.1: Total gross loans and advances considered under COVID-19 Relief Package; ($)thousands



Source: CBSI

Moreover, the pandemic also exerted pressure on the superannuation sector's earnings and liquidity. The market value of shares and equities, and expected returns from investment portfolios could worsen further if the pandemic persists. These effects would directly affect the sector's commitment to reward its members and absorb excessive losses.

Vulnerabilities arising from deterioration in premium receipts as a result of the impacts of the COVID-19 pandemic remains a concern for the insurance sector.

The impacts of the pandemic have already led to a contraction in net premiums due to cancellations and non-renewals of insurance policies. Hence, it is possible that the sector could see further reduction in premium receipts owing to continued reduction in number of policies due to closure of businesses or redundancy of employees. Such scenarios would definitely dampen the level of premiums and subsequently liquidity to support the sector's operation.

Vulnerabilities arising from tight liquidity as a result of impacts of COVID-19 remained a concern for the superannuation sector, banking sector, and credit unions.

It is likely that further reduction in members' contributions could materialize if another wave of COVID-19 relief package is given by the superannuation fund. A second wave of payouts is likely to dwindle the level of liquidity and accelerate the administration costs for the fund.

Any liquidity pressure that is shouldered by the superannuation sector is expected to be felt by the banking sector. This is because the superannuation sector is a significant contributor to the overall liquidity in the banking sector and the entire financial system. Furthermore, mass withdrawals by bank customers due to travel restrictions could reduce the liquidity of some of the banks to support their operations.

Like the banking sector, uncertainties surrounding the pandemic and government's measures to control spread of the virus could lead to mass withdrawals of savings by concerned members in the credit union sector. This can easily hinder operations of the credit unions.

Vulnerabilities arising from weak credit activities due to COVID-19 remains a concern for the banks and credit unions.

It is obvious that the pandemic could elevate the current level of business disruptions and dilute confidence in both the local and international markets for new business opportunities. Hence, reduce appetite of banks, credit institutions, and credit unions to lend to businesses and households. Slowdown in lending activities could affect overall economic growth.

Vulnerabilities arising from deterioration in the value of financial instruments and depreciation of foreign currency denominated investments due to COVID-19 remains a concern for the superannuation sector.

The Fund's foreign assets on average accounted for $341.3 million and constituted 84.9 percent of the total capital and reserves at end of June 2020. Given this significant foreign currency open position, any further deterioration in market value of investments and depreciation of concerned foreign currencies could reduce the Fund's overall balance sheet and profitability.

2.2 Risks and Policy Responses

Eventhough the financial system remained stable at end of June 2020, it continued to face headwinds emanating from mounting pressures from the impacts of COVID-19 and the changing business environment both domestically and internationally. It becomes clear that, amongst others, credit risk, liquidity risk, investment risk and underwriting risk have been the obvious risks witnessed in the second half of 2020.

Fortunately, these risks had not been unnoticed but with diligent work from the Board and management teams of the Financial Institutions and the supervisory role performed by the Central Bank combined to principally contain these risks within bay. The risks and microprudential policy responses are outlined below.

Credit risk arising from loan underwriting and premium underwriting remained a concern for the banks and insurance insurers.

The banking sector continued to witness presence of credit risk arising from loan underwritings by respective licensed financial institutions (LFIs) in the last six (6) months. The recovery actions to reduce the level of NPLs have slowed which could lead to further accumulation of NPLs on the concerned LFIs' balance sheets at end of 2020.

The level of non-performing loans (NPLs) has elevated further by 9.1 percent from December 2019 to $298 million in June 2020. The nonperforming loans to total gross loans ratio (NLLR), which indicates the portion of loans that does not generate income for banks and credit institutions remained above the Central Bank's internal threshold limit of 5 percent and increased slightly from 10.4 percent in December 2019 to 10.8 percent in June 2020. This is the highest NLLR in three years.

Likewise, with the current broking arrangement, the insurance sector had recorded a slight increase in debtors at end of June 2020, underpinnned by the slow premium payments by policyholders as result of unstable cashflow. Despite its significance at the time for this report, accummulation of delayed premium payments by policyholders could dilute insurers ability to sustain their operations.

Credit risks arising from excessive credit concentration remained a concern for some banks and credit institutions.

Even though the top five credit exposures to total regulatory capital ratio declined from 77.9 percent in December 2019 to 76.2 percent in June 2020, some banks and credit institutions continued to record significant level of exposures hovering above 85 percent concentrations and remaining high in respect of their capital. For the banking sector and as per the Central Bank requirement, the prudent exposure ceiling limit should be at 25 percent for a single borrower. While some of the banks and credit institutions have maintained lower thresholds, some have significant exposures close to or in excess of the prudential exposure ceiling limit in June 2020, threatening their level of capital and capacity to absorb unexpected shocks and maintain stability in the future.

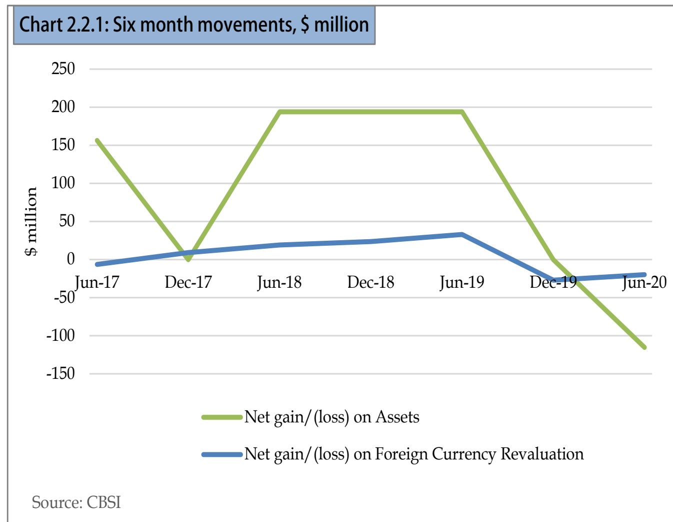
Profitability risk arising from impact of COVID-19 remained a concern for banks, credit institutions, superannuation, insurers, and credit unions.

While it is not necessarily driven by changes in interest rates; the supension of loan repayments by banks, credit institutions, and credit unions, payouts by the superannuation fund to members as well as premium payment holidays by insurers had compounded the profitability risk. All the sectors have recorded significant falls in their profitability levels.

Investment risk arising from impact of COVID-19 remained a concern for the superannuation fund.

Both the pandemic and volatility in market conditions have directly contributed to the sharp fall in noninterest income of the Fund to a negative $134.9 million at end of June 2020. As shown on Chart 2.2.1 below, the loss of $134.9 million pointed to loss on assets and foreign currency revaluation for the period. The loss from asset revaluations continued from zero in December 2019 to negative $115.3 million in June 2020 while the loss from foreign currency revaluation slightly improved from a negative $27 million in December 2019 to a negative $19.7 million in June 2020.

Chart 2.2.1: Six month movements, $ million



Source: CBSI

Liquidity risk arising from deposits concentration remained a concern for some banks and credit institutions.

Tight concentration of wholesale deposits held by some banks and credit institutions is a notable concern given the absence of clear liquidity concentration risk appetite in terms of large depositors. While work on determining most relevant limits is in progress, FIs are expected to thoroughly review their liquidity portfolios and establish liquidity appetite limits especially for their large depositors.

The impact of COVID-19 had proven that high concentration is a risk and mass withdrawals in the event of a crisis can be detrimental without parent support.

Prudential policy response to mitigate credit risks arising from impact of COVID-19.

In its effort to minimize the impacts of COVID-19 pandemic on Solomon Islands' banking sector and the overall financial system, the CBSI, on 30th March 2020, waived the application of the provisions of Prudential Guideline No.2 on Asset Classification and Minimum Provision Requirements (PG2) and paragraph 7 of Prudential Guideline No. 8 on Disclosure of Interest, Fees and Charges (PG8). The former aims to ensure loans that are considered under the COVID-19 Relief Package should not be classified as restructured loans nor attract a minimum of 20 percent provisions for loan losses, while the latter is to allow banks and credit institutions implement changes to interest rates, fees & charges without having to publish them for 30 days as required under PG8.

Prudential policy response to mitigate liquidity risk arising from the impacts of COVID-19.

The Central Bank through the Monetary Policy Committee (MPC) revised the Cash Reserve Requirement Ratio (CRR) in the second half of 2020. The CRR was reduced to 5 percent from 7.5 percent. The revision had provided commercial banks with additional liquidity to support their operations and intermediation activities.

CHAPTER 3: DOMESTIC FINANCIAL SECTOR DEVELOPMENTS

3.1 Banking Sector Performance

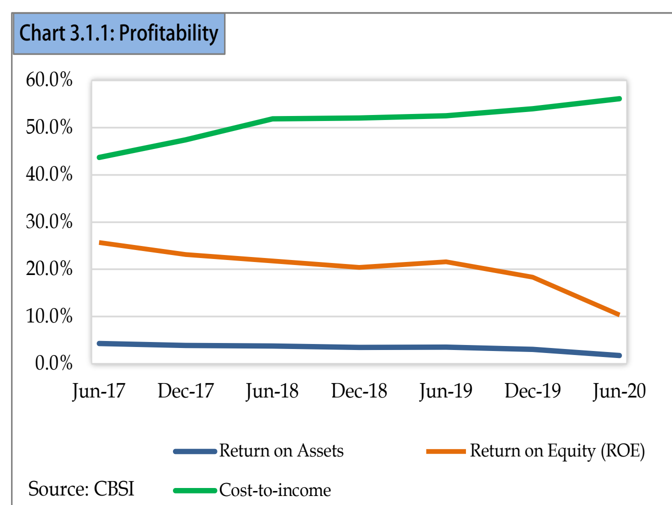
The banking sector[3] holds 60.3 percent of the total financial system assets in the first half of 2020, up from 59.9 percent in the second half of 2019. Moreover, it continues to play its intermediary role, which is crucial for the Solomon Islands economy, despite the many challenges of doing business in the country.

The first half of 2020 saw further reduction in physical presence of banks in provincial capitals in the country. Amongst others, the trend underpinned limited infrastructures to support banking sector operations in the provinces.

To bridge the gap of rural population not accessing banking services, banks have introduced alternative means through provision of digital banking services, however it would require ample time for households to understand, accept, and use the digital financial services, especially where the digital environment is not supported by adequate infrastructure for the effective delivery of the digital banking services. In addition to the existing challenges, the banking sector witnessed in the first half of 2020 the impact of COVID-19 pandemic that held its lending activities to a standstill and narrowed its profitability. Despite the challenges, the banking sector remained resilient claiming a net profit after tax of $35.3 million and recording total assets of $6.1 billion[4] at end of June 2020.

3.1.1 Profitability

The profitability and earnings of the banking sector remained adequate despite the impacts of COVID-19. The return on assets ratio (ROA) and return on equity (ROE) plummeted by 1.8 percent and 10.3 percent respectively in June 2020 compared to a 3.1 percent and 18.3 percent fall each respectively in December 2019 (Chart 3.1.1).



The fall was largely due to decreased interest income and noninterest income arising from the high nonperforming loans, and suspension of interest payments as well as elevated loan loss provision expenses and administration expenses at the end of the reporting period.

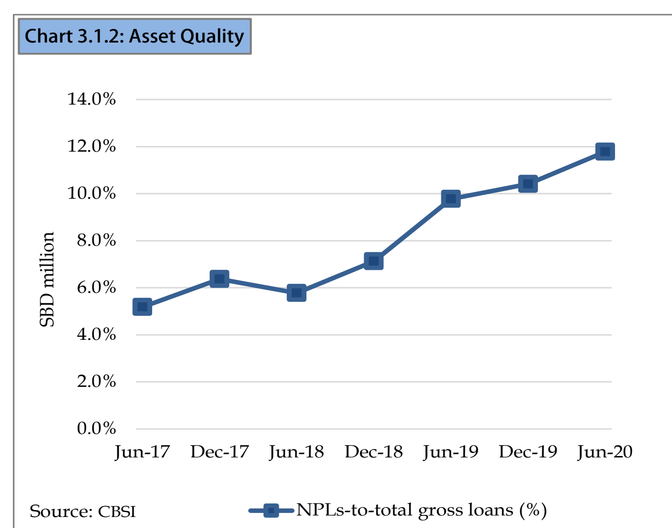
The suspension of interest reflected a total loan value of $448.1 million that had been considered by banks and credit institutions under the COVID-19 relief package in the first half of 2020. Interest on loans and advances have been suspended for repayment period ranging from 3 months to 6 months per customer since February 2020.

The rising NPLs has attracted additional provision expenses in June 2020 while the surge in operation expenses was attributed to increased administrative and occupancy expenses. The latter reflects the high rental expenses in the market.

Furthermore, operating expenses are expected to increase as banks and credit institutions expand their office spaces, workforce and upgrade their information technology platforms to meet their business needs while at the same time mitigate inherent risks. Given the adequate level of provision for loan losses and capital, impact of a further fall in profitability in the banking sector could be minimal in the second half of 2020.

3.1.2 Asset quality

The quality of assets as reflected by the level of performing asset remained adequate despite the soaring NPLs at end of June 2020.



The NPLs to total gross loans ratio continued to soar in June 2020. The ratio rose to 11.8 percent from 10.4 percent in December 2019 (Chart 3.1.2). While the level of NPLs ratio might not be material in terms of the overall profitability of the banking sector, it was significantly higher than the Central Bank's internal threshold limit of 5 percent.

[3] Maintained four (4) commercial banks and two (2) credit institutions at the end of June 2020.

[4] Total Gross Assets minus Interest in suspense on loans and advances, specific provisions for losses on loans and accumulated depreciation.

The increased ratio was triggered by the rise in value of NPLs due to the increase in total loans and advances. NPLs edged higher to $297.9 million in June 2020 from $266.3 million in December 2019. The steady increase in NPLs was mainly driven by current market conditions; backed by the impact of COVID-19 for existing NPLs portfolios, chronic delay by Solomon Islands Government (SIG) payments to its contractors who secured loans from banks and credit institutions, mismanagement of funds by borrowers, and slowdown in business activities from adverse weather conditions and poor competitions.

In terms of key economic sectors, household debts as defined by the personal sector continued to dominate the NPLs portfolio prior to June 2020. At end of June 2020, personal sector constituted 26.3 percent, followed by construction 21.7 percent, transportation 18.2 percent, and distribution 15.1 percent.

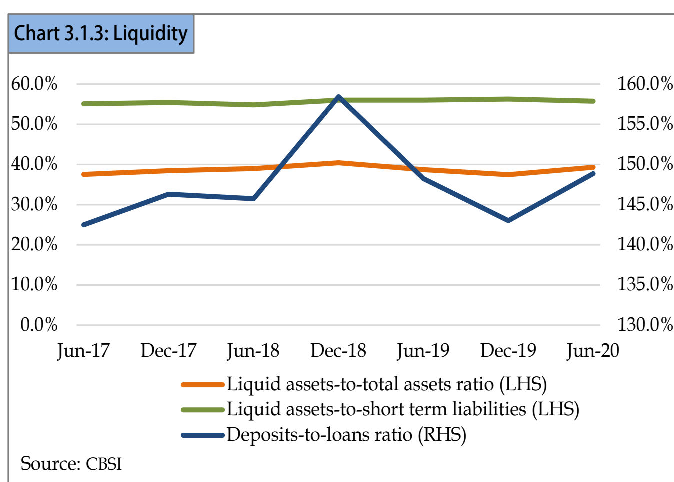
While the level of NPLs is immaterial, the upward trend in NPLs from the personal sector is a concern since almost all loans and advances to the sector are secured by the two-third pledge offered by the Solomon Islands National Provident Fund. Usage of members' contributions to settle their loans could reduce their retirement benefits if their debts are not cleared.

Notably, all loans have been secured and with the current level of capital to absorb losses, the deterioration in NPLs remained immaterial. However, the use of collaterals to secure debts could discourage banks and credit institutions from providing customers additional credit to contribute to the overall economic activities of the country in the future.

3.1.3 Liquidity

The level of liquidity of the banking sector remained adequate despite the impact of COVID-19 pandemic.

Chart 3.1.3: Liquidity



Source: CBSI

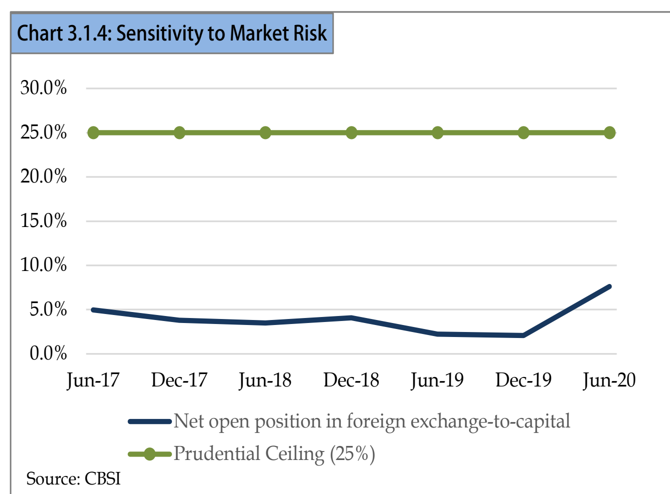
The level of liquidity is implicated by the following ratios: liquid assets to short term liabilities ratio, at 55.7 percent, deposits to loan ratios at 148.9 percent and liquid assets to total assets ratio at 39.3 percent as at end of June 2020. These ratios indicate the banking sector have ample liquidity to meet demand deposits withdrawal and other obligations as and when due, despite the slight increase in deposits to loan ratio from 148.2 percent in June 2019 to 148.9 percent June 2020.

The increase in deposits to loan ratio reflected the banks and credit institutions commitment to serve its customer's payment needs and even to expand its asset base. The banking sector's level of liquidity remained well above the Central Bank's minimum cash reserve requirement (CRR) of 5.0 percent. The excess cash reserve stands at 33.1 percent as at end of June 2020. The CRR is measured as demand balances held with Central Bank of Solomon Islands (CBSI) to total deposit liabilities of the banking sector.

3.1.4 Sensitivity to market risk

With the high capital level held by the banking sector, both the net single foreign currency open position and the net overall foreign currency open position as percentages of total capital remained relatively lower than the prudential limits of 15.0 percent and 25.0 percent, respectively, as at end of June 2020 (Chart 3.1.5).

Chart 3.1.4: Sensitivity to Market Risk



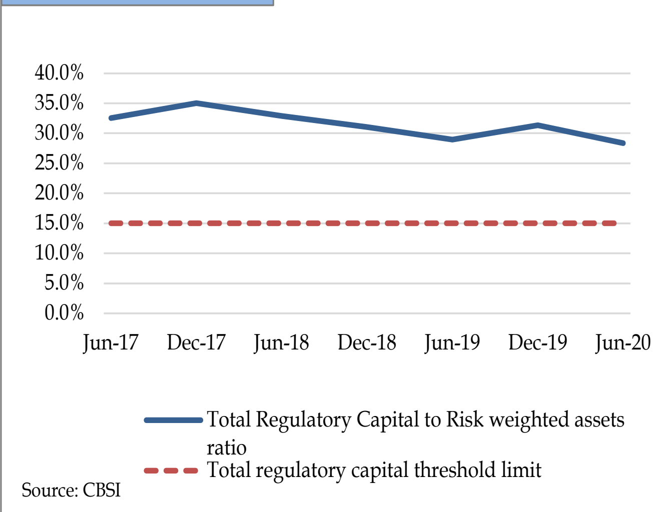
Source: CBSI

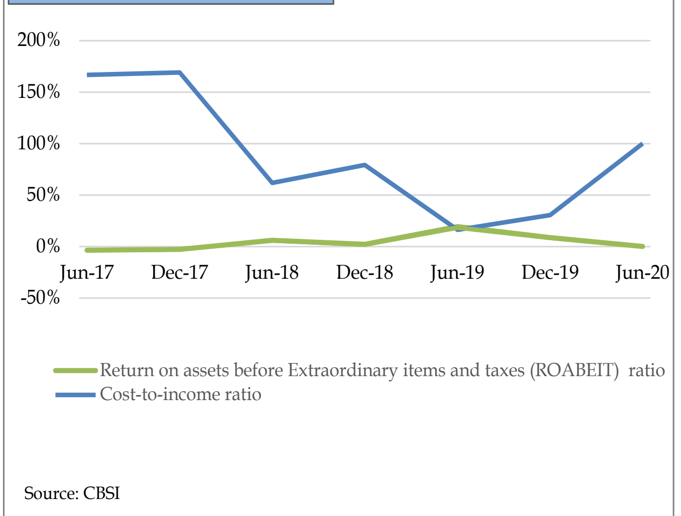
The total net foreign currency open position increased significantly from $21.8 million in December 2019 to $79.2 million at the end of June 2020. This is reflected by the surge in overall net foreign currency open position to capital increasing to 7.6 percent from 2.2 percent during the reporting period.

The compounding level of total net foreign currency open position indicates high trading activities involved in both imports and exports during the reporting period. Despite the increasing net open position in foreign exchange to capital, banks are conducting businesses in a profitable and yet prudent manner as at end of June 2020. Moreover, the United States Dollar (USD) continued to be the major leading trading currency during the review period.

3.1.5 Capital Adequacy

In terms of capital adequacy, the banking sector maintained adequate level of capital as at end of June 2020.





Banking sector total regulatory capital fell from $799.2 million in December 2019 to $784.8 million end of June 2020. The fall is mainly due to the repatriation of retained earnings as dividends to head offices offshore during the reporting period. Total regulatory capital to risk weighted assets ratio also fell from 31.3 percent in December 2019 to 28.4 percent during the reporting period (Chart 3.1.5). Despite the fall in the total regulatory capital to risk weighted assets ratio, it is still well above the CBSI minimum internal threshold limit for total regulatory capital requirement of 15 percent.

Despite the fall in the capital level, the overall banking sector has ample capital to cushion against losses that might arise in the short to medium term. The sector-maintained 13.4 percent in excess of the required minimum regulatory threshold of 15 percent as at end of June 2020.

3.2 Superannuation Sector Performance

The superannuation sector constitutes 37.2 percent of the total assets of the Solomon Islands financial system, second only to the banking sector. The Solomon Islands National Provident Fund (the Fund), which still remains as the only superannuation fund in the country, has a total membership of 148,776 in June 2020. This was a decline of 6.2 percent against December 2019 and was largely due to a rise in loss of formal employment and a sudden increase in the number of formerly retiring members that withdrew all their savings during the Fund's COVID-19 relief payment program.

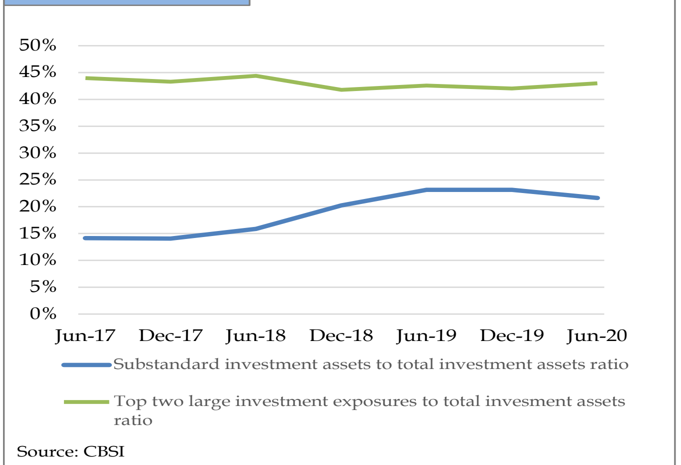
3.2.1 Profitability

The COVID-19 pandemic, coupled with the subdued market conditions, have suppressed the ability of the earning assets to generate adequate income for the Fund to sustain its operations. This resulted in the Fund recording a return on assets before extraordinary items and tax ratio (ROABEIT) of zero percent in June 2020, compared to 8.6 percent in December 2019 and 19.4 percent in June 2019 (Chart 3.2.1).

The zero percent growth in ROABEIT indicates a significant fall in noninterest income while personal and administration expenses continue to grow. Unfavorable outcome in both the former and latter stemmed from the impact of COVID-19.

3.2.2 Asset quality

Based on the Central Bank preliminary classification, the level of substandard assets reached two digits in June 2020. As shown on Chart 3.2.2, there was a slight improvement in the quality of assets as shown by the fall in substandard investments to total gross investments ratio from 23.2 percent in December 2019 to 21.6 percent in June 2020. The Fund has developed and implemented an asset aging framework and is expected to ensure quality of assets are identified, monitored and reported on regular basis and correct provisions are carried on to book for the non-performing assets. A robust aging framework should help minimize volatility in the Fund's investments as well as interest and noninterest income arising from the said investments.



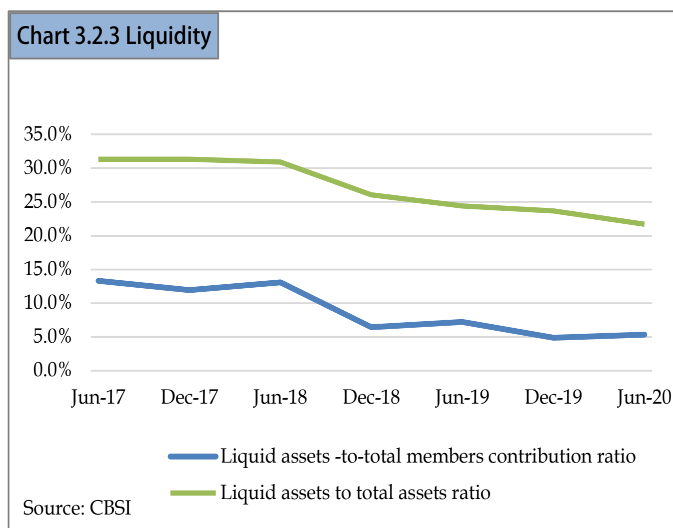
In addition, the first half of 2020 continued to witness a stable investment exposure as indicated by top two investment exposures to total investment ratio on

Chart 3.2.2. The ratio remained around 47 percent since December 2019. The Board and management of the Fund are aware of the investment and credit risks these investments have on the Fund's book and are working on appropriate strategies to reduce these exposures.

3.2.3 Liquidity

Although the profitability of the Fund had deteriorated in June 2020, the Fund's liquidity remained adequate especially in a non-crisis situation. The Fund was able to meet all its dues as for the reporting period despite pressures imposed by the impact of COVID-19 which resulted in recalling of some of the time deposits from the banking sector. As shown in Chart 3.2.3, liquid assets to total contribution slightly picked up from 4.9 percent in December 2019 to 5.3 percent in June 2020. The moderate rise reflected the COVID-19 relief payments made by the Fund to the affected members. Time deposits which was largely used to settle affected members decreased by 14 percent from December 2019 to $642.6 million in June 2020 against a fall in the members contributions by 3.6 percent from same period in 2019 to $3,154.6 million for the same period in 2020.

Chart 3.2.3 Liquidity



Source: CBSI

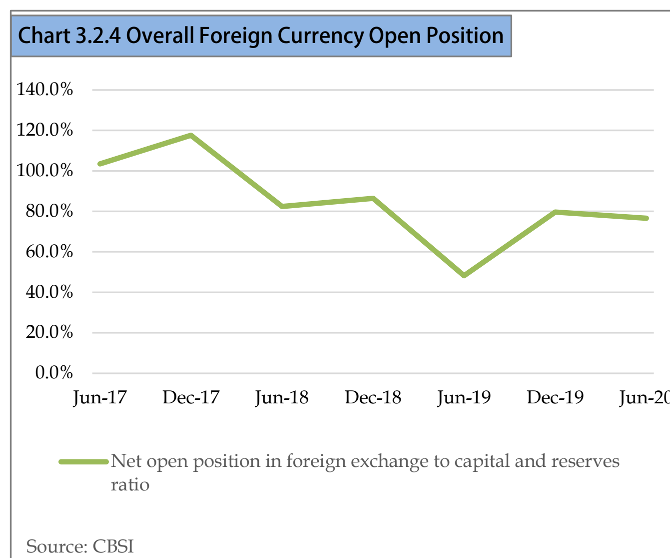
Notwithstanding the current stock of liquid assets, pressure on liquidity might result in tight liquidity position or shortage in liquid funds if further requests are made for subsequent payouts due to the impact of the pandemic in the second half of 2020. This is possible given only 21.7 percent of total assets are held in liquid assets while 78.3 percent are held in illiquid assets (Chart 3.2.3).

3.2.4 Sensitivity to Market Risk

The Fund remained exposed to market risk especially during the current COVID-19 situation. This was indicated by the volatility in the value of the Fund's financial instruments which reflects fluctuations in the value of the foreign currency denominated investments and foreign exchange rates.

Despite the steady decline, the Fund's overall foreign currency open position (FCOP) since December 2017 remained high against the level of capital & reserves. The Fund's foreign currency open position to capital and reserve ratio fell to 76.6 percent in June 2020 from 79.7 percent in December 2019 (Chart 3.2.4). Unlike commercial banks, the Fund might not have robust mechanism to trade foreign currencies to swiftly mitigate losses arising from devaluation of financial instruments and depreciations of foreign currencies against the Solomon Islands Dollar (SBD).

Chart 3.2.4 Overall Foreign Currency Open Position



Source: CBSI

3.2.5 Capital adequacy

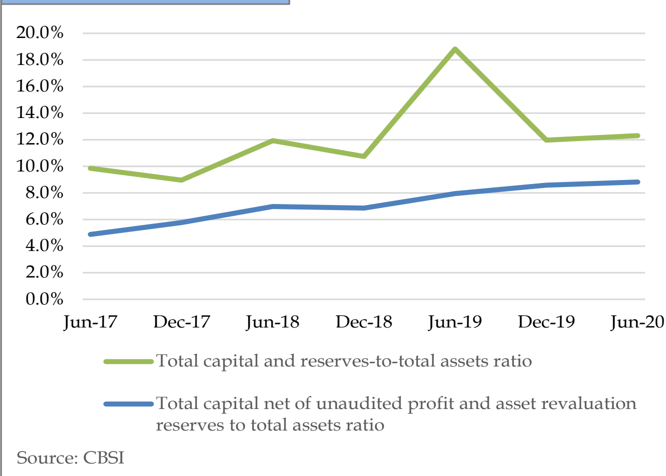
The Fund witnessed a zero-capital growth in June 2020. Hence, pressure on capital remained a concern given the uncertainty regarding the presence of COVID-19 regionally and globally. Further deterioration in quality of assets or investment could see further reduction of capital. The capital to asset ratio was hovering around 12.3 percent, which is below the regulatory threshold limit of 15% in June 2020 for the banking sector.

Historically, total capital and reserves net asset revaluation reserves to total assets ratio has been trailing behind the tier 1[5] regulatory capital ratio of 7.5 percent for the banking sector. It stood at 8.8% in June 2020, a slight improvement from 8.6 percent in December 2019.

The way the level of capital is trending appears that the sector would not withstand further shocks. This is because shareholders (members) might not be willing to pump additional contributions to support the sector's operation.

[5] "Tier 1 capital" means capital which (i) represents a permanent and unrestricted commitment of funds, (ii) is freely available to absorb losses, (iii) does not impose any unavoidable charge on the earnings of the financial institution, and (iii) ranks below the claims of depositors and other creditors in the event of the winding-up of the financial institution.

Chart 3.2.5 Capital adequacy



Source: CBSI

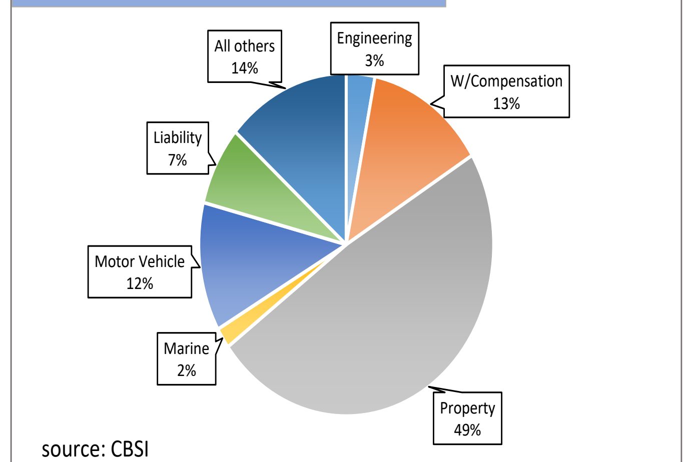
Notwithstanding the level of capital, the availability of capital might not be adequate to absorb any immediate shocks given 20 percent of the total capital represent asset revaluation reserves. In the absence of any economic shocks, it is desirable that the sector maintains a threshold above 15 percent in terms of its capital adequacy ratio.

3.3 Insurance Sector Performance

The local insurance industry[6] transitioned into 2020 at a sturdy shape, posting a 3 percent growth in gross premium over the second half of 2019 following a 10 percent expansion recorded in the second half of 2018. However, this positive momentum was short-lived due to the emergence of the COVID-19 pandemic which caused slowdown in business activities witnessed across the first half of 2020. This retraction in business activities has restricted the ability of local policyholders to renew their policies, resulting in considerable number of policy cancellations and non-renewals. Consequently, this effected downward pressure on the sector's gross premium income[7] by 27 percent, down from $38 million in the second half of 2019 to $27.7 million in the first half of 2020. The decline was largely attributed to reductions in overall premium inflows for motor vehicle, workmen's compensation and other miscellaneous classes of insurance[8]. Motor vehicle plunged to a record low of 52 percent while workmen's compensation and other miscellaneous classes of insurance plummeted by 43 percent and 40 percent respectively.

Engineering, property, marine and liability classes also declined but at a relatively slower pace. A breakdown by major sources of income by insurance class showed that property classes remained the largest contributor to the industry's premium pool over the six months period to June 2020, representing 49 percent of the sector's overall premium income, followed by other miscellaneous classes, which accounted for 14 percent and workmen's compensation contributing 13 percent.

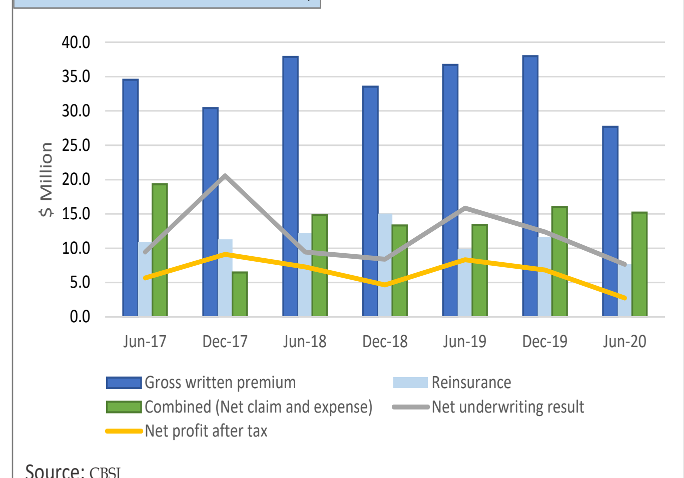
Chart 3.3.1: Share of Premium Income by Class of Insurance



source: CBSI

Despite the negative premium performances in the first half of 2020, the sector remained profitable but at relatively lower digits compared to the second half of 2019. The outcome was largely attributed to weak underwriting performances, underpinned by the fall in overall premium inflows along with an increase in net claims witnessed over the period. These have exerted negative pressures on the sector's net profit after tax, causing it to fall immensely by 60 percent to $2.7 million at the end of June 2020 (Chart 3.3.2).

Chart 3.3.2: Insurance Sector Profitability



Source: CBSI

In the first half of 2020, the sector also witnessed a spike in weather related claims as a result of cyclone Harold that struck the country in the early months of the year. This triggered an upsurge in net claims by 44 percent, up from $4.3 million to $6.2 million. Despite the upturn, the sector's loss ratio remained sturdy at 30.9 percent reflecting sufficient level of premium that offsets net claims recorded over the period. This indicated strength in the sector's solvency position to cushion claims when due.

Expense ratio also increased but at a relatively slower pace, mirroring a decline in overall expenses against net premium recorded during the period. Concisely, the

[6] The Insurance industry consist of three insurers, four brokers and one agent.

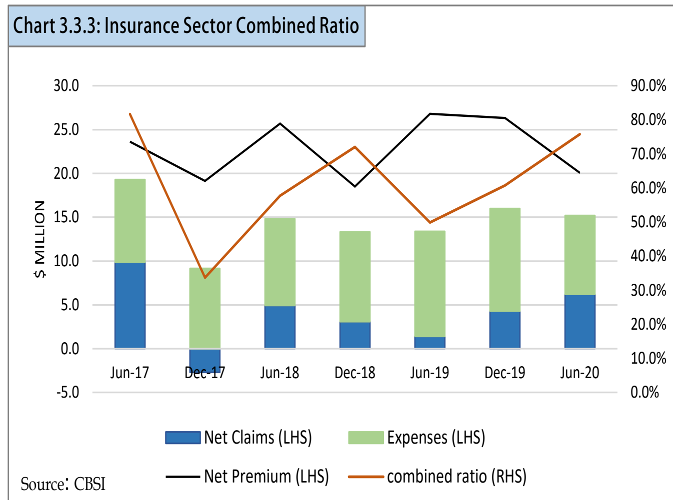
[7] The main source of revenue for the insurance industry

[8] Other miscellaneous classes of insurance refer to smaller or sub-classes that are usually less purchased by the public.

decline reflected a fall in commission expenses, along with a reduction in other operating and management expenses over the period.

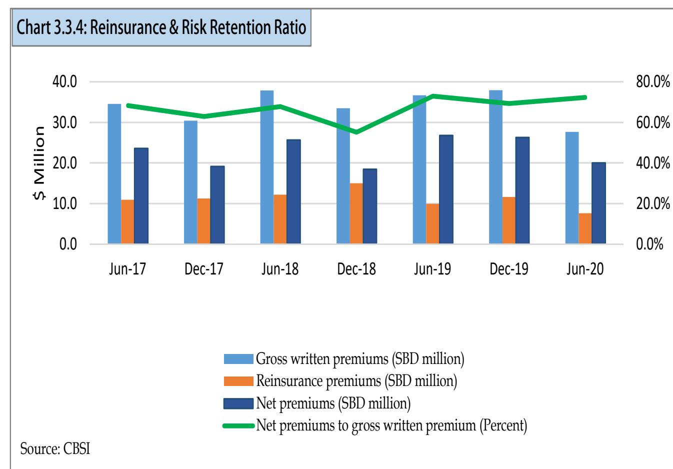
As a result, the insurance industry's combined net claims and expenses dwindled over the period. This backdrop together with the sluggish premium performances levered the sector's combine ratio upwards by 15 percentage points. The outcome mirrored sufficient premium inflow that cushioned the level of net claims and expenses amid weak underwriting performance in the first half of 2020.

Chart 3.3.3: Insurance Sector Combined Ratio



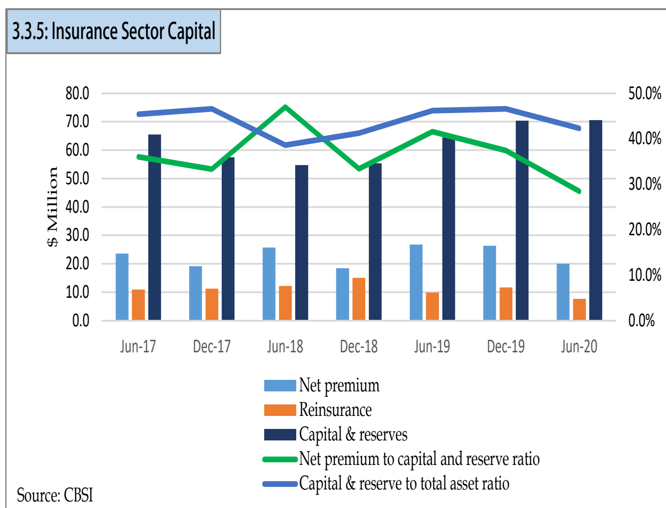
The insurance industry continued to manage their risk exposure through the purchase of reinsurance contracts. Total reinsurance premium stood at $7.6 million at the end of June 2020, down from $11.7 million recorded in the preceding period. This outcome was mainly driven by the decline in overall premium income. However, the sector's risk retention ratio rose to 72.4 percent at the end of the assessment period (Chart 3.3.4). The ratio implied that 72.4 percent of risk underwritten by the industry were retained while approximately 27.6 percent ceded to reinsurers. This indicated sufficient risk bearing capacity by the industry to undertake insured risks that exist within the economy.

Chart 3.3.4: Reinsurance & Risk Retention Ratio



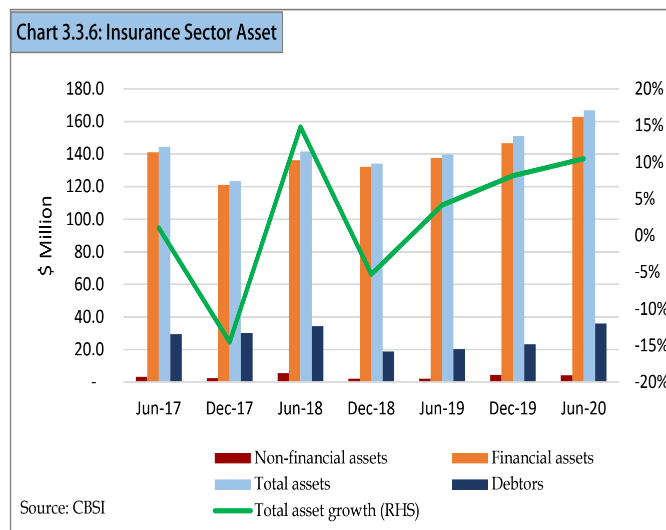
Moreover, amidst economic pressures from the pandemic as well as other natural disaster events, the insurance industry remained strong to leverage financial losses incurred by its policyholders. Net premium to capital and reserve ratio dwindled by 9 percentage points, down from 37.4 percent in December 2019 to 28.4 percent at end June 2020 (Chart 3.3.5). This backdrop was attributable to the fall in net premium, underpinned by non-renewals and policy cancellations witnessed during the period. However, despite this outcome, the sector's premium to capital and reserve ratio remained sturdy mirroring sufficient capital and reserve to cover the level of risk retained by the industry. Correspondingly, capital to asset ratio also declined from 46.6 percent to 42.3 percent by the end of June 2020, owing to the rise in total asset.

3.3.5: Insurance Sector Capital



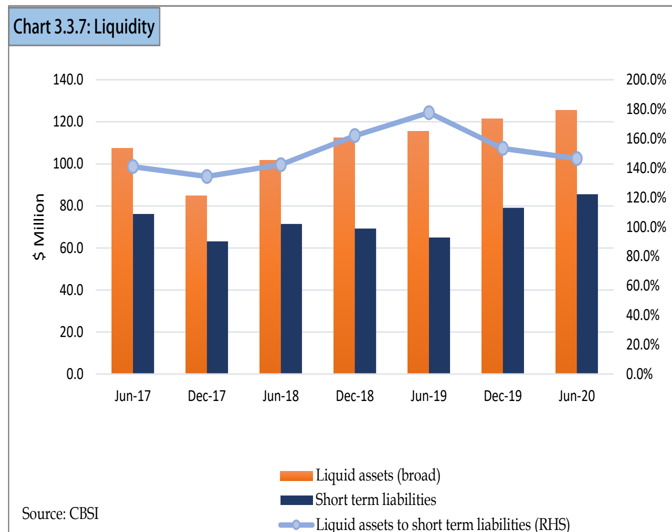
The sector continued to register positive growth in its total assets, a trend witnessed since the first half of 2018. Overall assets expanded further by 10 percent to $166.9 million in the first six months to June 2020 (Chart 3.3.6). The increase was mainly attributed to a growth in financial assets which resulted from an upturn in currency and deposits held with commercial banks. Further improvements in the sector's technical reserves also contributed to this outcome. Conversely, the insurance industry also witnessed a slight increase in debtors over the period pointing to slow premium payment by policyholders on the back of unstable cash flows during the period.

Chart 3.3.6: Insurance Sector Asset



The insurance industry, in the first half of the year maintained sufficient liquidity to meet its short-term dues. Liquid assets expanded further albeit at a slower pace relative to the rise in short-term liabilities. This triggered a decline in the sector's liquid to short-term liabilities by 4 percent. Growth in the sector's liquid asset reflected an increase in currency and deposits held with commercial banks. Total currency and deposits rose significantly by 49 percent to $109.4 million over the period, pushing the sector's overall liquid asset upwards by 3 percent from $121.4 million to $125.4 million. On the other hand, the growth in the sector's short-term liabilities was underpinned by rise in reinsurance and claims liabilities. Total reinsurance and claims liability went up by 25 percent, levering the industry's overall short-term liabilities upwards by 8 percent to settle at $85.6 million. Despite the increase in short-term liabilities, the rise was insufficient to match the buoyancy of the sector's liquidity position. As a result, the industry's liquidity ratio remained sound, recording 146.5 percent over the period to June 2020.

Chart 3.3.7: Liquidity



Source: CBSI

3.4 Credit Union Sector Performance

Credit union activities remained muted across the first six months of the year. Based on the ten (10) reporting credit unions, the sector's total assets remained unchanged as in the previous six months representing 0.8 percent of the total assets of the overall financial system at end of June 2020. Like other sectors, the credit union sector was also impacted by COVID-19. However, it was able to contain the effects and recorded profit at the end of the reporting period.

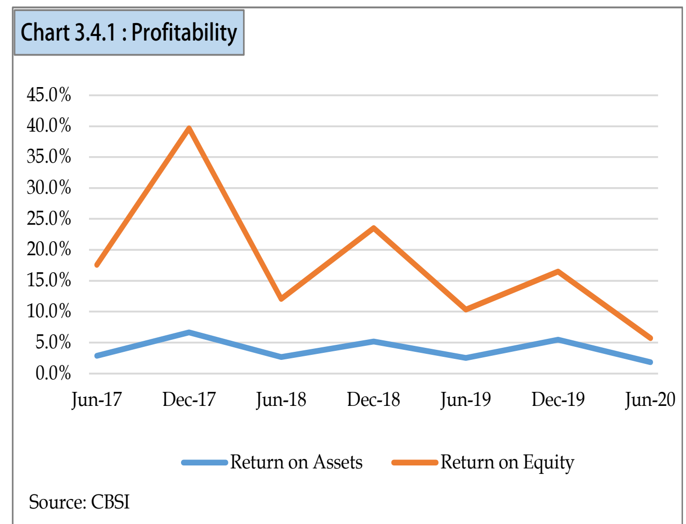
3.4.1 Profitability

Net profit to total asset ratio (ROA) and net profit to total equity (ROE) fell significantly to 1.8 percent and 5.7 percent respectively in June 2020 from 5.5 percent and 16.5 percent respectively in December 2019 (Chart 3.4.1). The downward trend is attributed to the low-income receipts due to the suspension of loan repayments coupled with narrow lending activities in the first half of 2020.

Despite the suspension of loan repayments as one of the measures taken to mitigate financial hardships experienced by members due to the impacts of Covid-19, the sector witnessed marginal growth in its total assets and loans and advances in June 2020. Total assets grew by 2.1 percent from $79.8 million in December 2019 to $81.5 million in June 2020. The growth was largely backed by the increase in total loans and advances. Loans and advances - the major earning assets of the credit union sector – continued to dominate the asset portfolio of the credit union sector. It reached $52.6 million in June 2020 compared to $50.7 million in December 2019. Similarly, total deposits edged higher from $50.4 million in December 2019 to $51.2 million in June 2020. While it is understood that stringent measures taken by employers to lay off staff (members) during the first half of 2020, withdrawals of members did not affect the inflows of savings by existing members.

Capital of the sector, stood at $26.2 million in the first half of 2020 and comprised largely of shares deposits, retain earnings and reserves. The sector made a profit of $1.5 million despite the challenges and uncertainties of COVID-19 in the first half of 2020. Apart from the financial performance, the credit union sector continued to face challenges in terms of robust information system and adequate board and committee oversight.

Chart 3.4.1 : Profitability



Source: CBSI

APPENDICES

APPENDIX 3.1: BANKING SECTOR

Table 3.1.1 Income Statement ($million)

	Jun 17	Dec-17	Jun-18	Dec-18	Jun-19	Dec-19	Jun -20
1. Interest income	128.5	258.2	129.0	261.8	132.4	268.9	129.5
2. Interest expense	7.3	15.1	8.3	17.9	10.3	23.1	11.2
3. Net Interest Income (= 1 - 2)	121.2	243.1	120.8	243.9	122.0	245.8	118.3
4. Non interest income	98.3	199.0	103.6	203.0	110.9	212.9	85.3
(i) Fees and commissions receivable	13.9	26.7	16.2	35.9	18.8	39.2	19.5
(ii) gains or losses on financial instrumenits	72.1	147.7	59.8	119.3	73.5	138.5	57.5
(iii) Prorated earnings	0.0	0.0	0.0	0.0	0.0	0.0	0.0
(iv) Other Income	12.3	24.6	27.6	47.8	18.6	35.2	8.2
5. Gross income (= 3 + 4)	219.5	442.1	224.3	446.8	232.9	458.7	203.6
6. Noninterest expenses	95.9	209.8	116.3	232.6	122.3	247.7	114.3
(i) Personal costs	31.4	71.2	36.5	72.0	37.0	73.4	36.8
(ii) other expenses	64.5	138.6	79.8	160.6	85.3	174.2	77.6
7. Provisions (Net)	10.3	21.6	-0.8	9.3	1.9	23.5	35.6
(i) Loan loss provisions	10.3	21.7	-0.8	9.2	1.7	23.6	35.6
(ii) Other finanacial asset provisions	0.0	-0.1	0.0	0.2	0.3	-0.1	0.0
8. Net income (before extraordinary items and taxes) (= 5 - (6+7))	113.3	210.8	108.8	204.9	108.7	187.6	53.7
9. Extraordinary items	0.0	0.0	2.5	2.5	0.0	2.2	0.0
10. Income tax	38.1	76.0	40.3	75.4	38.1	63.4	18.3
11. Net income after extraordinary items and taxes (= 8 - (9+10))	75.2	134.8	66.1	127.0	70.6	121.9	35.4

Source : CBSI

Table 3.1.2 Balance Sheet ($million)

	Jun-17	Dec-17	Jun-18	Dec-18	Jun-19	Dec-19	Jun-20
12. Total Assets (= 13 + 14 = 25)	5,264.3	5,687.8	5,756.4	6,131.8	6,144.0	6,070.2	6,057.2
13. Nonfinancial assets	133.0	162.4	176.5	178.1	198.2	200.2	206.0
14. Financial assets (=15 to 18)	5,131.3	5,525.4	5,580.0	5,953.7	5,945.8	5,870.0	5,851.1
15. Cash and deposits	2,084.1	2,306.8	2,382.3	2,718.8	2,623.2	2,510.7	2,591.8
16. Loans (after specific provisions)	2,174.0	2,303.3	2,360.3	2,383.5	2,454.1	2,479.1	2,446.1
(i) Gross loans	2,200.5	2,331.1	2,392.5	2,437.3	2,517.0	2,557.4	2,529.2
(ii) specific provisions	26.5	27.8	32.1	53.7	62.8	78.3	83.1
17. Debt securities	764.7	766.3	764.8	773.8	782.9	782.1	703.1
18. other assets	108.6	149.1	72.6	77.5	85.5	98.1	110.1
19. Liabilities (=23 + 24)	4,393.5	4,697.3	4,778.9	5,117.8	5,140.5	5,025.4	5,018.3
20. Currency and deposits	4,193.3	4,441.7	4,624.0	4,926.5	4,880.8	4,790.8	4,772.5
21. Loans	3.1	2.3	3.7	5.5	7.1	1.1	0.4
22. Other Liabilities	197.1	253.3	151.1	185.7	252.6	233.5	245.4
23. Debt (= 20 + 21 + 22)	4,393.5	4,697.3	4,778.9	5,117.8	5,140.5	5,025.4	5,018.3
21. Capital and reserves	870.8	990.5	977.5	1,014.1	1,003.5	1,044.8	1,038.9
25. Balance Sheet total (= 23 + 30 =12)	5,264.3	5,687.8	5,756.4	6,131.8	6,144.0	6,070.2	6,057.2

Source : CBSI

APPENDIX 3.2: SUPERANNUATION SECTOR

Table 3.2.1 Income Statement ($million)

	Jun-17	Dec-17	Jun-18	Dec-18	Jun-19	Dec-19	Jun-20
1. Interest income	116.1	147.9	120.0	159.1	167.9	198.7	150.8
(i) Gross interest income	100.2	117.4	105.5	129.0	155.3	175.0	144.7
(ii) Rental income	15.8	30.5	14.6	30.1	12.6	23.6	6.0
2. Interest expense	-	-	1.0	-	-	-	-
3. Net interest income (= 1 - 2)	116.1	147.9	119.1	159.1	167.9	198.7	150.8
4. Noninterest income	-30.1	-22.1	173.5	175.3	248.0	263.6	-90.7
(i) Contribution surcharges	1.4	2.9	1.8	3.2	1.2	2.9	1.7
(ii) Gains or losses on finanacial instruments	-31.9	-25.7	170.3	161.4	235.5	249.1	-134.9
(iii) Prorated earnings							
(iv) Other income	0.4	0.7	1.4	10.7	11.3	11.6	42.6
5. Gross income (= 3 + 4)	86.0	125.8	292.5	334.4	415.9	462.3	60.1
6. Noninterest expenses	42.9	79.6	47.5	98.0	46.3	84.1	44.9
(i) Personnel costs	8.2	14.9	8.1	15.3	7.6	16.2	14.5
(ii) Board and outsourcing expenses	0.6	1.4	0.4	1.4	0.5	1.3	0.3
(iii) Administration expenses	12.5	23.7	13.2	24.6	15.3	27.8	29.0
(iv) Other expenses	21.6	39.6	25.8	56.8	22.8	38.8	1.0
7. Provisions (net)	-	0.6	11.9	-	-	-	-
(i) Loan loss provisions	-	-	-	-	-	-	-
(ii) Other financial asset provisions	-	0.6	11.9	-	-	-	-
8. Net income (before extraordinary items and taxes) (= 5 - (6+7))	43.1	45.6	233.1	236.4	369.6	378.2	15.2
9. Extraordinary items	-	-	-	-	-	-	-
10. Income tax	-	-	-	-	-	-	-
11. Net income after extraordinary items and taxes (= 8 - (9 +10))	43.1	45.6	233.1	236.4	369.6	378.2	15.2
12. Interest paid to members	100.3	133.0	133.3	166.6	20.7	57.3	15.2
13. Dividends payable	-	-	-	-	-	-	-
14. Retained earinings after interest paid to memebers and dividends payable (= 11 - 12 - 13)	-57.3	-87.4	99.9	69.8	348.9	320.9	-0.02

Source: CBSI

Table 3.2.2 Balance Sheet

	Jun-17	Dec-17	Jun-18	Dec-18	Jun-19	Dec-19	Jun-20
1. Total Assetd (= 2 + 3)	3,185.9	3,169.9	3,486.0	3,468.1	3,840.9	3,829.9	3,734.1
2. Nonfinancial assets	437.9	446.3	483.8	500.6	608.9	631.5	680.5
3. Financial assets (= 4 to 9)	2,748.0	2,723.6	3,002.2	2,967.5	3,232.1	3,198.4	3,053.6
4. (i) Currency and demand deposits	367.3	330.6	386.8	192.3	215.5	158.6	167.0
(ii) Time deposits	629.9	662.8	690.2	711.1	721.8	747.4	642.6
5. Loans	143.1	126.7	126.0	140.6	124.5	111.6	150.6
6. Debt securities	196.7	194.5	197.2	206.6	218.9	228.0	264.3
7. Shares and other equities	1,341.7	1,347.3	1,541.4	1,651.4	1,894.1	1,907.0	1,745.2
8. Accrued interest and dividend Receivables	40.1	30.6	28.7	31.0	25.6	13.7	39.3
9. Other assets	29.2	31.2	32.1	34.5	31.6	32.0	44.5
10. Liabilities (=16 + 17)	2,872.1	2,885.9	3,069.7	3,095.5	3,118.3	3,371.6	3,274.5
11. Curency and deposits							
12. Loans	-	-	2.2	2.9	4.5	-	2.0
13. Debt securities							
14. Members contribution, Specials death benefits and Nominees trust accounts	2,766.9	2,780.9	2,959.2	2,992.0	2,998.4	3,272.9	3,154.6
15. Other liabilities	105.2	105.0	108.3	100.6	115.5	98.6	117.9
16. Debt (=11 to 15)	2,872.1	2,885.9	3,069.7	3,095.5	3,118.3	3,371.6	3,274.5
17. Capital and reserves	313.7	284.0	416.3	372.6	722.6	458.3	459.6
18. Balance Sheet Total (=10 + 17 = 1)	3,185.9	3,169.9	3,486.0	3,468.1	3,840.9	3,829.9	3,734.1

Source: CBSI

APPENDIX 3.3: INSURANCE SECTOR

Table 3.3.1 Income Statement ($million)

	Jun-17	Dec-17	Jun-18	Dec-18	Jun-19	Dec-19	Jun-20
1. Total premium	34.5	30.4	37.9	33.5	36.7	38.0	27.7
2. Outward reinsurance	10.9	11.3	12.2	15.0	9.9	11.7	7.6
3. Premium net of reinsurance (= 1 - 2)	23.6	19.2	25.7	18.5	26.8	26.3	20.1
4. Unearned premium reseerves	-2.1	-5.3	1.0	-2.9	1.1	-0.1	-1.3
5. Net earned premium (= 3 - 4)	25.7	24.5	24.7	21.4	25.7	26.5	21.3
6. Gross claims expense	7.9	0.4	9.1	2.4	2.2	6.9	10.5
7. Total recoveries	-2.0	3.1	4.2	-0.7	0.8	2.6	4.3
8. Net claims expense (= 6 - 7)	9.9	-2.7	4.9	3.1	1.4	4.3	6.2
9. Commission Expense	3.5	4.3	4.7	4.2	3.8	4.5	3.3
10.Total underwriting expenses (= 8 + 9)	16.3	3.9	15.3	13.0	9.9	14.1	13.7
11. Underwriting Results (= 5- 10)	9.4	20.6	9.4	8.4	15.8	12.4	7.7
12. Insurance Results (=17 + 18 - 19)	9.7	20.6	9.7	8.7	16.2	12.7	6.9
13. Other operating income	0.0	0.1	0.0	0.1	0.0	0.0	0.0
14. Other operating expenses or manangement expenses	5.1	5.3	3.6	4.2	5.9	4.4	3.2
15. Net Profit (Loss) Before Tax (= 11 + 12 - 13)	4.6	15.5	6.1	4.6	10.3	8.3	3.8
16. Income tax or provisions	3.4	2.8	3.2	2.9	3.7	3.4	1.1
17. Net Income (Loss) End of Current Period (= 14 - 15)	5.7	9.1	7.3	4.6	8.3	6.8	2.7

Source: CBSI

Table 3.3.2 Insurance Sector Balance Sheet ($million)

	Jun-17	Dec-17	Jun-18	Dec-18	Jun-19	Dec-19	Jun-20
18. Total Assets (= 18 + 19)	144.4	123.4	141.7	134.2	139.7	151.1	166.9
19. Nonfinancial assets	3.3	2.3	5.5	2.1	2.1	4.5	4.1
20. Financial assets (= 20 to 26)	141.1	121.0	136.2	132.1	137.6	146.6	162.8
21. Currency and deposits	61.1	38.4	49.5	65.0	67.8	73.5	109.4
22. Loans	-	-	-	-	-	-	-
23. Debt securities	46.4	46.5	52.1	47.3	47.6	47.8	16.0
24. Insurance technical reserves	29.5	30.2	34.3	18.9	20.2	23.2	36.0
25. Other assets	4.1	6.0	0.3	0.9	2.0	2.0	1.5
26. Liabilities	78.9	65.2	81.2	83.2	81.0	86.6	96.9
27. Insurance Technical reserves	76.2	63.2	71.4	69.3	65.0	79.2	85.6
28. Other liabilities	2.7	2.0	9.8	13.9	16.0	7.4	11.3
29. Capital and reserves	65.5	57.5	54.7	55.3	64.5	70.4	70.6
30. Balance Sheet Total (= 25 + 28 = 17)	144.5	122.7	135.9	138.5	145.5	157.0	167.5

Source: CBSI

APPENDIX 3.4: CREDIT UNION SECTOR

Table 3.4.1 Summary of Financial Statement ($million)

	Jun-17	De-c17	Jun-18	Dec-18	Jun-19	Dec-19	Jun-20
Income statement							
Income	2.9	6.6	2.9	6.5	4.4	8.9	2.9
Expenses	1.0	2.2	1.1	2.9	2.5	4.6	1.4
Net Surplus	1.9	44	1.8	3.6	1.9	4.3	1.5
Balance sheet							
Total Loans and advances	44.6	44.2	46.1	47.8	50.3	50.7	52.6
Total Assets	66.1	66.4	71.5	70.7	85.1	79.8	81.5
Total Deposits / Savings	50.4	50.6	52.4	51.7	63.1	50.4	51.2
Total Share Capital	10.8	11.1	14.9	15.3	18.4	26.1	26.2

Source: CBSI