

CENTRAL BANK OF SOLOMON ISLANDS

FINANCIAL STABILITY REPORT

December 2021

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

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This report is based on unaudited and provisional data of banks and non-bank financial institutions available up to December 31st, 2021 unless stated otherwise in the relevant chapters/sections.

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Abbreviations

CBSI	Central Bank of Solomon Islands
1H21	First half of 2021, which ended 30th June 2021
2H21	Second half of 2021, which ended 31st December 2021
NPS	National Payment System
SIG	Solomon Island Government
WBG	World Bank Group
IFC	International Financial Corporation
UAT	User Acceptance testing
SINPF	Solomon Islands National Provident Fund

Chapter 1: OVERVIEW OF INTERNATIONAL & DOMESTIC FINANCIAL CONDITIONS

1.1: International Financial Condition

The risk of financial instability remained anchored as the global economy traverses through the pandemic. Economic recovery started to emerge in the first half of 2021, backed mainly by policy support from governments and central banks around the world. Yet the pathway to full recovery remained divergent across different sectors and economies, in part due to the emergence of new COVID-19 variants, the high vaccination hesitancy ratio and the vaccination disparities experienced in some countries. Thus, raised concerns over the outlook of the global economic recovery and its sustainability. Amidst the recovery process, pockets of vulnerabilities surfaced which pose new challenges to the global financial system.

The resurgence of virus infections resulted from the emergence of new COVID-19 variants across the second half of 2021 (2H21) persistently and concurrently disrupted the global economy. This compelled affected countries to reimpose containment measures to curb the spread of the variants. Unfortunately, such measures have disrupted global supply chains and prompted price hikes in certain international commodities. As a result, inflation remained persistent than initially anticipated across 2H21 and a tightening of monetary policy was imminent to curb inflationary pressures. For some emerging and developing economies as well as frontier market economies, risks to financial stability were contained, owing to the continued monetary and fiscal support by advanced economies. However, early tightening of monetary policy by advanced economies would elevate tight financial conditions and higher rates that would adversely impact capital flows and fuel debt serviceability issues. This would impede growth in the medium term and put a drag on economic recovery. Nevertheless, monetary and fiscal support is crucial to facilitate a sustainable recovery, but it must be carried out diligently to avoid a sudden unmasking of tight financial conditions and potential unmooring of inflation that could result from fiscal stimulus.

COVID-19 has also accelerated digital transformation in the financial ecosystem. While these transformations are vital to support and fast-track the recovery process in such a time of restrictive physical contact, it also brings about new risks and vulnerabilities to the financial system. Besides cyber risk, one of the most notable risks to the financial system is digital currency, in particular, the crypto assets. Rapid growth in crypto assets poses new risks to the financial system as its cross-border operations may elevate operational and financial integrity risks. The increased trading of crypto asset could affect existing foreign exchange and capital management regimes, leading to destabilization of capital flows. Its nature of overly decentralized finance, coupled with poor disclosure itself, is a risk to its investors and the financial system. Furthermore, it can potentially result in runs if its reserves are being questioned due to deterioration in the dollar values of its backed assets. Financial regulators are put against

the odds to try to manage the risk given limited historical data on such developments. This necessitates the need for closer collaboration between regulators to address the challenge of digital dollarization and the impact it may have on the global financial system.

Besides COVID-19 related risks, developing countries have continued to grapple with challenges imposed by climate change. In particular, for small developing economies, climate change has imposed severe risks with notable damages to food security and infant mortality, lower productivity and output losses, deteriorating health outcomes, rising poverty and inequality, and heightened macroeconomic and financial instability. Moreover, investors and banks alike are reserved from investing in areas that are highly exposed to climate change disasters. Conversely, climate change has also unmasked investment opportunities in green finance related projects. Green finance investment is crucial in facilitating a transition into a greener economy, but this transition will mean phasing out the fossil-fuel sector and replacing it with renewable energy. However, the transition to the green economy itself might have some financial stability implications as the pathways towards full transition will be uneven across countries due to different dynamics, causing uncertainties during the process. Risks pertaining to the green economy transition would stem mainly from the fossil fuel sector. If not managed well, this may trigger transition shock that could proliferate large repricing of affected assets and conceiving financial stability risk.

1.2: Domestic Financial Condition

On the domestic front, the last six months of 2021 have been very challenging for the Solomon Islands economy. The perennial stress induced by the pandemic and the Honiara riot that occurred in late November 2021 disrupted the expected economic rebound, resulting in a negative growth of 0.6 percent from minus 4.3 percent posted in 2020¹. The outcome mirrored negative growths witnessed in forestry, wholesale and retail, education, and transport sectors. Meanwhile, construction, fisheries, manufacturing, and copra production maintained positive growths during the period.

The sluggish economic growth, the impact of the November riot, and the uncertainties associated with the COVID-19 pandemic have negatively impacted government finances and labour market conditions. These events have exerted enormous pressures on government finances, debt service capabilities of corporate and domestic household entities, the mortgage market, the volume of asset quality in the system and the employment level of the country. Hence, decisive policy responses are crucial to mitigate any negative spillovers from such interactions on the overall economy.

¹ Obtained from CBSI's quarterly economic review, December 2021

In the financial sector, the banking sector ² and superannuation sector continued to produce profitable results in 2H21, despite the slow economic performance. The former's profitability stemmed from credit growth and gains in financial instruments while growth in the profitability of the latter came from gains in portfolio investments and rental income from its properties. Subsequently, total assets for both sectors grew by 4.5 percent and 6.3 percent respectively from 1H21 to 2H21, reinforcing further both sectors' asset position and financial resilience to withstand shocks going forward. Similarly, the credit union sector continued to maintain profitability but at a much slower pace. The outcome pointed to a general reduction in lending activities which subsequently dragged down the revenue for the sector over the period.

On the other hand, the insurance sector recorded a loss during the period. The outcome reflected the impact of the Honiara riot, which triggered a surge in insurance claims against a slowdown in overall revenue. Nevertheless, the sector's total asset and capital levels remained adequate to absorb losses in the short-to-medium term.

Meanwhile, Solomon Islands is embarking on establishing a National Payment System (NPS). This NPS, once established, will assist in facilitating a safer and more efficient payment platform thereby increasing financial access and at the same time, promoting and maintaining financial stability. However, the progress of the NPS was hobbled by the ongoing health crises and cross border travel restrictions.

In light of the developments within the financial sector, pockets of risk and vulnerabilities persist which if left unchecked, can potentially destabilize the domestic financial system. Among others, credit risk, liquidity risk, and the cyber risk appeared to be the most common risks faced by each sector.

On another note, the government's policy decision to cut back its rental entitlement for its public employees could rekindle further vulnerabilities in the financial system. This policy decision has caused anxiety among the banks, credit institutions and homeowners. This is because most landlords have mortgages and depend very much on rental income to service their loans. Since government employees are the highest number of tenants, a cutback in their rental entitlements would lead to a reduction in rental income for most landlords. This could affect loan repayment causing an increase in non-performing loans (NPL), especially in the housing loan portfolio. As a result, it may put pressure on banks and credit institutions' capitals which will affect their solvency position.

Considering the risk and vulnerabilities facing the financial sector, the CBSI will continue to ensure that decisive actions are taken to keep the risk and vulnerabilities at

bay. This is critical to ensure financial stability prevails in order to support economic growth going forward.

1.3: National Payment System

Building a modern Payment System Infrastructure is essential for a safer and efficient way of facilitating payments to promote and maintain financial system stability along with increasing the level of financial access. Driven by that objective, the CBSI and SIG in collaboration with World Bank Group (WBG) and International Financial Corporation (IFC) and other stakeholders have developed the National Payment System (NPS) for Solomon Islands.

The National Payments Bill 2020 is before Parliament for enactment. The Central Bank will ensure the Payments System is successfully implemented for an efficient and inclusive payment service delivery to support economic activities in the country.

² Banking sector includes both commercial banks and credit institutions

Chapter 2: FINANCIAL SECTOR RESILIENCE

2.1: Banking Sector Resilience

The Banking Sector remained resilient and sound in 2H21. Despite the pandemic and the weak economic conditions, the banks maintained strong capital adequacy ratio (CAR) of 32.9 percent, significantly above the 15 percent regulatory minimum threshold. The notable increase in non-interest income in 2H21 contributed to the positive return on assets ratio. Correspondingly, the banks maintained greater liquidity resilience as revealed by the acceptable levels of deposit to loans and liquid assets to total assets ratios (See Table 1). While the sector's overall liquidity remained structurally higher than the industry's short-term obligations, liquidity positions for individual banks

remained uneven. In 2H21, the banks maintained normal operations despite brief disruptions. Non-performing loans dropped, as banks write off legacy loans from their books.

Table 1: Banking Sector Financial Soundness Indicators, 2H18 - 2H21

	2H18	1H19	2H19	1H20	2H20	1H21	2H21
Capital Adequacy							
Total regulatory capital-to-risk weighted assets ratio (RWAs) (CAR) >15%	31.1%	28.9%	31.3%	29.2%	33.7%	33.4%	32.9%
Tier 1 regulated capital to risk weighted assets ratio >7.5%	30.0%	28.9%	30.8%	29.2%	31.5%	33.0%	31.2%
Nonperforming loans (NPLs) net specific loan loss provisions-to-capital & reserves	11.8%	18.3%	18.0%	20.2%	16.6%	18.1%	13.9%
Asset Quality							
NPL-to-total gross loans ratio	7.1%	9.8%	10.4%	11.8%	10.6%	11.4%	10.4%
Specific loan loss provisions-to-NPLs (Coverage Ratio)	30.9%	25.5%	29.4%	27.9%	29.9%	28.7%	36.4%
Earnings & Profitability							
Return on Assets (ROA)	3.5%	3.6%	3.1%	1.8%	2.1%	2.5%	2.3%
Return on Equity (ROE)	20.4%	21.4%	18.3%	10.0%	11.8%	13.4%	12.4%
Net-interest Income to Gross Income	54.6%	52.4%	53.6%	58.2%	59.1%	59.6%	58.2%
Cost-to-income ratio	52.1%	52.5%	54.0%	56.4%	57.1%	58.3%	55.7%
Non-interest income-to-gross income	45.4%	47.6%	46.4%	41.8%	40.9%	40.4%	41.8%
Personnel expenses-to-noninterest expenses <35%	30.9%	30.2%	29.7%	32.2%	31.2%	34.4%	32.5%
Interest spread	10.4%	10.1%	10.0%	9.8%	9.6%	9.2%	9.1%
Liquidity							
Deposits-to-loans ratio	158.4%	148.2%	143.0%	148.8%	152.7%	147.8%	152.0%
Liquid assets-to-total assets ratio	40.4%	38.7%	37.4%	39.5%	45.4%	46.5%	46.4%
Sensitivity to Market Risks							
Net open position in foreign exchange-to-capital <25%	4.1%	2.2%	2.1%	7.4%	2.4%	2.4%	2.9%

Source: Central Bank of Solomon Islands

2.2: Superannuation Sector Resilience

The 2H21 review finds that the superannuation sector³ remained resilient despite the unprecedented challenges of COVID-19, weak labour market conditions, and the November 2021 riots and looting in Honiara. Closure of businesses, particularly in Honiara, as a result of the unfortunate events did not dampen contribution inflows during the reviewed period. The sector's resilience was a testament to the unwavering commitment of the Fund's management to counteract the impact of COVID-19 on the sector's core investments in 2H21 and to ensure the sector's capital and liquidity positions remain adequate.

proliferating the industry's loss ratio to 63.1 percent in 2H21 from 17.1 percent in 1H21 (Table 1- Insurance Sector FSI). As a result, the industry's combined ratio grew by 35 percentage points to 104.2 percent, reflecting an unfavourable profitable position for the industry during the period (Table 1 insurance sector FSI). Despite the weak profitable position, the sector's resilience remained intact due to the sector's robust capital adequacy level. In terms of ratio, the sector has a capital adequacy ratio of 23.4 percent and a ratio of capital and reserves to total assets of 42.6 percent in 2H21. These were manifestations of capital build-ups accumulated

Table 2: Superannuation Sector Financial Soundness Indicators, 2H18 - 2H21

	2H18	1H19	2H19	1H20	2H20	1H21	2H21
Capital Adequacy							
Capital to total assets (L >15%, M>10%, H>7.5%, E<7.5%)	10.7%	18.8%	12.0%	12.3%	9.2%	11.9%	11.8%
Asset Quality							
Substandard investment assets to total investment assets (L <5%, M>5%, H>10%, E<20%)	3.3%	3.5%	3.4%	3.2%	2.3%	1.2%	0.9%
HHI (Exposure by Class) (L <1001, M>1001, H>2001, E>4901)	3040.3	3070.3	3056.1	2959.5	2972.6	2920.1	3019
Earnings & Profitability							
Return on earning assets ratio (L >=2.5%, M<2.5%, H<1.5%, E<=-1.5%)	11.6%	12.3%	7.9%	10.0%	6.1%	7.7%	4.8%
Cost to income ratio (L <50%, M>50%, H>70%, E>85%)	29.3%	11.1%	18.2%	74.7%	104.7%	23.0%	21.0%
Return on assets ratio (L >5%, M>1%, H>0.5%, E<0.5%)	2.0%	18.2%	8.4%	0.0%	-0.6%	6.8%	7.9%
Liquidity							
Liquid assets to total value of members contribution ratio (L >30%, M<29.9%, H<19.9%, E<14.9%)	30.2%	31.2%	27.7%	25.7%	24.9%	26.2%	22.7%
Liquid assets to total assets ratio (L >20%, M<20%, H<15%, E<10%)	26.0%	24.4%	23.7%	21.7%	22.0%	22.5%	19.5%

Source: Central Bank of Solomon Islands

2.3: Insurance Sector Resilience

The insurance industry traversed through turbulent times as COVID-19 induced economic pressures continued to jeopardize the industry's performance. This situation was further exacerbated by the riot in November 2021 that resulted in the incineration of commercial properties in Honiara, forcing them to cease operations. These led to a cutback in economic activities, causing limited business opportunities for local insurers and, subsequently derailing the industry's overall growth performance in 2H21. The aftermath of the recent riot posed significant impact on the industry's profitability. Net profit position of the industry plunged by 151 percent from \$4.5 million in 1H21. The outcome was largely driven by a rise in property claims as a result of the riot and other attritional weather-related claims. Total claims surged by 156 percent,

over the years; and signifies sufficient capital to cushion immediate economic shocks that would arise from the sector's inherent risks that may potentially crumble insurers' solvency position.

In terms of its liquidity resilience, the industry's liquid asset to short-term liabilities ratio subsided over the period. This came on the back of a decline in liquid assets against an up-trending short-term liability. The industry's liquid assets fell by 6 percent, owing to a decline in cash and deposits coupled with a drop back in debt securities and other assets. On the other hand, short-term liabilities rose by 9 percent mainly due to growth in outstanding claims and unearned premium liabilities. These outcomes subsequently reversed the sector's liquid asset to short-term liability ratio by 14 percent from 184 percent in 1H21 to 159.1 percent in 2H21. Despite the increase in short-term liabilities, the industry's

³ Comprises of the only superannuation in the country which is Solomon Islands National Provident Fund (SINPF)

liquidity position remained sound to meet its short-term obligation when fall due - as the level of liquid assets was more than sufficient to cushion its liabilities in the near term. Similarly, the industry's asset quality continues to

Table 3: Insurance Sector Financial Soundness Indicators, 2H18 - 2H21

	2H18	1H19	2H19	1H20	2H20	1H21	2H21
Capital Adequacy							
Net Premium to Capital	33.4%	41.6%	37.4%	28.4%	26.6%	32.4%	23.4%
Capital & Reserves to Total Assets	41.2%	46.2%	46.6%	42.3%	47.4%	42.2%	42.6%
Asset Quality							
Debtors to Total Assets	14.0%	14.5%	15.4%	21.5%	24.3%	23.5%	25.0%
Debtors to (Gross Premium + Reinsurance)	57.5%	53.9%	57.3%	112.4%	158.8%	112.2%	135.8%
Reinsurance & Actuarial Issues							
Risk Retention Ratio	55.2%	73.0%	69.3%	72.4%	82.1%	67.6%	65.0%
Adequacy of Claims							
Loss Ratio (Net Claims to Net Premiums)	16.8%	5.2%	16.3%	30.9%	12.7%	17.5%	63.1%
Earnings & Profitability							
Expense Ratio (Expense to Net Premium)	55.3%	44.7%	44.5%	44.9%	35.9%	51.3%	41.0%
Combined Ratio (Net Claims + Expense to Net Premiums)	72.1%	49.9%	60.8%	75.8%	48.6%	68.8%	104.2%
Investment Income Ratio (Investment Income to Net Premium)	1.5%	1.2%	1.3%	-3.6%	1.7%	0.4%	1.7%
Return on equity	13.6%	20.0%	15.1%	5.4%	13.7%	7.5%	-1.6%
Liquidity Ratio							
Liquid Assets to Short Term Liabilities	162.1%	177.7%	153.3%	146.5%	170.8%	184.8%	159.1%

Source: Central Bank of Solomon Islands

show strong performance, posting higher debtors to gross premium and reinsurance ratio of 135.8 percent and 25 percent in debtors to total assets ratio respectively. This came on the back of positive growth in the sector's assets amidst negative pressure on its overall earnings.

2.4: Credit Union Sector Resilience

Despite the adverse impacts of the COVID-19 pandemic on the domestic economy, the Credit Union sector showed resilience and stability during the second half of 2021. The steadiness stemmed from reported positive financial performance and sustaining of capital adequacy above the required threshold of 10 percent in accordance with the Credit Union Act 1986. The high capital adequacy level indicated the Credit Union sector is well capitalised to absorb any credit losses and adverse economic circumstances.

Table 4: Credit Union Sector Financial Soundness Indicators, 2H18 - 2H21

	2H18	1H19	2H19	1H20	2H20	1H21	2H21
Balance Sheet (SBD million)							
Total loans	47.8	50.3	50.7	52.6	55.8	56.5	56.8
Total Assets	70.7	85.1	79.8	81.5	84.9	92.3	93.0
Total Deposits (savings)	51.7	63.1	50.4	51.2	51.3	54.2	55.0
Total Share capital	15.3	18.4	26.1	26.1	27.7	31.9	31.6
Income Statement (SBD million)							
Income	3.6	4.4	4.5	2.9	4.2	3.8	4.3
Expenses	1.8	2.5	2.1	1.6	2.6	2.3	3.1
Net Surplus	1.8	1.9	2.4	1.5	1.6	1.5	1.2
Statistics							
Membership	6,700	6,750	6,790	6,795	6,800	6,850	6,850
No. of Reporting Credit Unions	10	10	10	10	10	10	10
Indicators							
Capital Adequacy (>10%)	22%	22%	33%	32%	33%	35%	34%
Earnings & Profitability							
ROA	2.5%	2.2%	3.0%	1.8%	1.9%	1.6%	1.3%
Loans to Assets	67.6%	59.1%	63.5%	64.5%	65.7%	61.2%	61.1%
ROE	11.8%	10.3%	9.2%	5.7%	5.8%	4.7%	3.8%
Self Sufficiency Ratio	200.0%	176.0%	214.3%	181.3%	161.5%	165.2%	138.7%

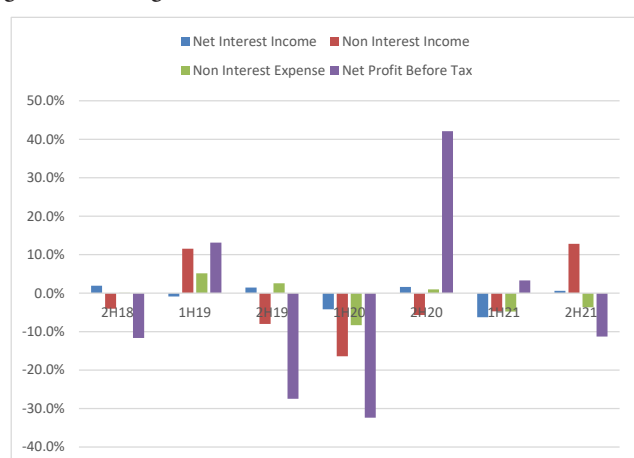
Source: Central Bank of Solomon Islands

Chapter 3: FINANCIAL SECTOR PERFORMANCE & DEVELOPMENTS

3.1: Banking Sector Performance

The Banking Sector produced another profitable result in 2H21 as measured by the positive return on assets ratio, despite the November riots and the continued impact of COVID-19 pandemic. Net profit before tax (NPBT) fell from 3.3 percent in 1H21 to a negative 11.3 percent in 2H21 which, in value terms, amounted to \$ 69.4 million (refer Fig. 1); this fall was led by an increase in loan loss provision expenses due to uncertainties associated with COVID-19 pandemic. The Sector’s profitability, nevertheless, remained positive predominantly stemming from increased lending activities, gains on financial instruments, and falls in non-interest expenses as banks adapted digital transformation strategies to amplify reach, reduce cost

Figure 1: Banking Sector Half-Year Growth, 2H18 - 2H21



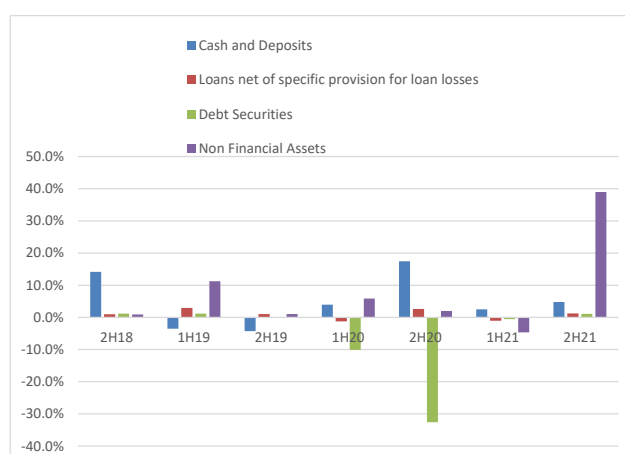
Source: Central Bank of Solomon Islands

and generate additional revenue.

The banks’ consolidated assets grew from \$6.39 billion in 1H21 to \$6.68 billion in 2H21 (Appendix 1.2). This growth reflected an increase in demand balances due from depository institutions; following a rise in off-shore loans and foreign currency term deposits. Probing further, all core assets of the Banking Sector grew in 2H21 but none more dramatic than non-financial assets, which expanded by 39 percent over the period, (see Fig.2) due to application of IFRS 16 leases.

Similarly, total deposits in the Banking Sector grew by 2.4 percent in 2H21 and continued to remain as a stable source of funding for the sector.

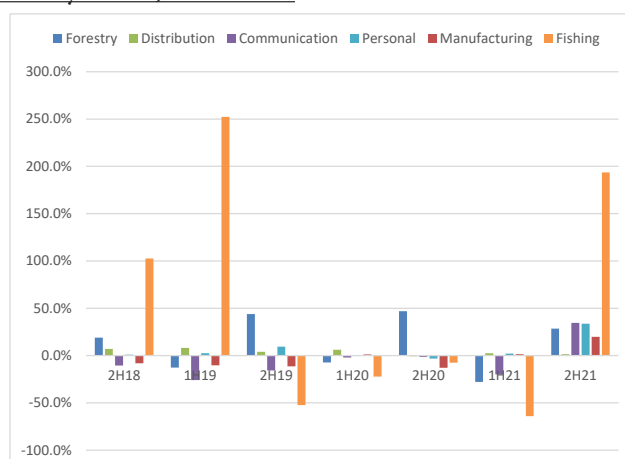
Figure 2: Banking Sector Half-Year Growth in Assets, 2H18 - 2H21



Source: Central Bank of Solomon Islands

During the review period, Banks’ lending activities persisted, with an increase in loans and advances by \$45.9 million which translated to a positive growth of 1.8 percent to \$2.61 billion level. The personal, communication, forestry, manufacturing, distribution, and fishing sectors have driven overall credit growth in 2H21 (See Fig.3). The upward trend reflects Bank’s appetite to continue lending to economically viable sectors whilst maintaining a quality loan book amidst the COVID-19 pandemic and its potentially detrimental implications on the asset quality of the Banking Sector.

Figure 3: Banking Sector Half-Year Growth in Key Loans and Advances by Sectors, 2H18 - 2H21

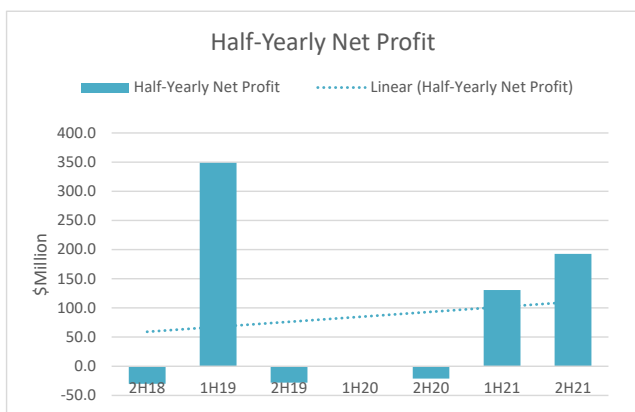


Source: Central Bank of Solomon Islands

3.2: Superannuation Sector Performance

The superannuation sector recorded another positive performance in 2H21 amid COVID-19 related disruptions and uncertainties. Net profit strengthened by 47.4 percent from 1H21 to \$193 million, an unprecedented record since 2H19 and remains above the pre-COVID-19 pandemic level. The improved performance was achieved mainly through a combination of income growth from both returns and gains from the shares and equities held in the Fund’s major subsidiaries⁴ and rental income from investment properties. Gains from shares and equities was partly due to the improvement in the countries credit ratings⁵ in which the investments were held. The combined interest income and noninterest income was able to financially cushion the noninterest expenses during the period, resulting in the sector’s profitability.

Figure 4: Superannuation Sector Half - Year Net Profit, 2H18 - 2H21



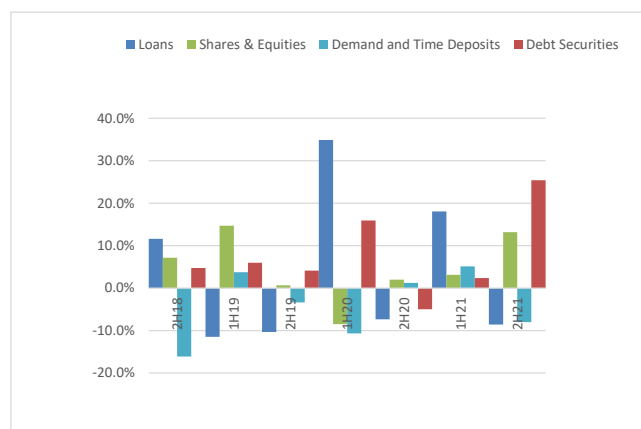
Source: Central Bank of Solomon Islands

The sector’s total investment assets continue to rise in 2H21 with domestic equities comprising a larger portion of the overall investment assets. This growth was supported by the commitment of Board and Management to financially reward members, reflecting in particular 6.3 percent growth in total assets to \$4072.9 million from 1H21, mirroring growth in the sector’s shares and equities; and debt securities. The 25.4 percent growth in shares and equities echoes a strong growth in the sector’s listed and unlisted equity fair values; along with ability to generate adequate income. Debt securities grew by 13.2 percent, amplified by the \$120 million government development bond purchased during 2H21; affirming SIG’s demand for additional funding to strengthen its effort to fight against COVID-19 pandemic in the country.

The consistent growth in the sector’s total assets demonstrates that COVID-19 protocols and government measures imposed supports maintenance of employment, hence did not curtail inflows of members contributions in 2H21. Number of memberships remained stable in 2H21.

4 South Pacific Oil Limited, Solomon Telekom Limited, Anthony Saru Building
5 Moody’s country rating

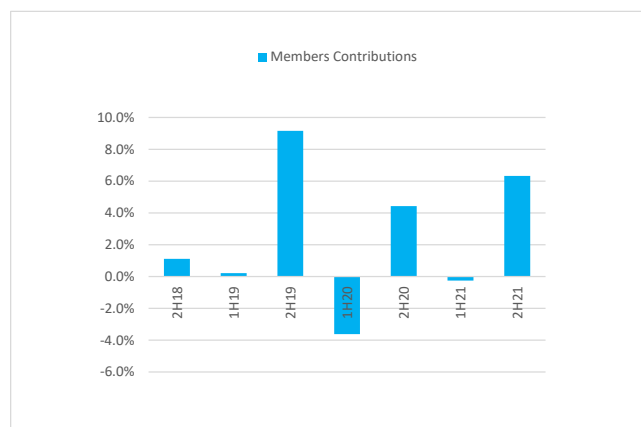
Figure 5: Superannuation Sector Growth in Major Assets, 2H18 - 2H21



Source: Central Bank of Solomon Islands

It stood at 293,435 of which 21 percent coming from the innovative YouSave platform. This signifies trust and commitment by both members from the formal and informal sectors to save towards their retirement benefits despite the pandemic. Members’ contributions grew moderately by 6.3 percent to \$3.49 billion in 2H21 from 1H21. Alongside the government’s goal to vaccinate a minimum 70 percent of its eligible population against COVID-19 nationwide, is also the renewed commitment and determination to sustain members contributions in the near to long term. By demography, there is fair distribution of members under and above 40 years of age. The former accounted for 41.5 percent and the latter constituted 48.5 percent in 2H21.

Figure 6: Superannuation Sector Growth in Dollar Value of Members Contributions, 2H18 - 2H21



Source: Central Bank of Solomon Islands

Capital and reserves, however, slowed down considerably in 2H21 with 4.7 percent growth against the 33.8 percent growth recorded in 1H21. The plummeting growth was inevitably due to accumulated losses during 2021 as a result of various factors including changes in value of unlisted equities from movements in country ratings; IFRS 9

compliance and end-of-year annual interest adjustments made in the last quarter of 2021.

3.3: Insurance Sector Performance

The insurance industry entered the second half of 2021 with great optimism, as signs of recovery started to emerge across the global economy during the first six months of 2021. However, this was deterred by the prevailing mobility restrictions due to emergence of new COVID-19 vari-

ant (See Appendix 3.1) in 2H21. Miscellaneous category registered the highest loss during the period. This was mainly riot related claim on policies that covers RSCC⁶ risk. Fortunately, a considerable number of riot related claims lodged by policyholders were either declined or reduced due to the absence of RSCC coverage and inadequate insurance protection, respectively.

As a result of the loss incurred in 2H21, the industry's aggregate assets dwindled by 2.8 percent. This came on the

Table 5: Insurance Sector Industry Distribution of Gross Written Premium by Class, 1H21 - 2H21

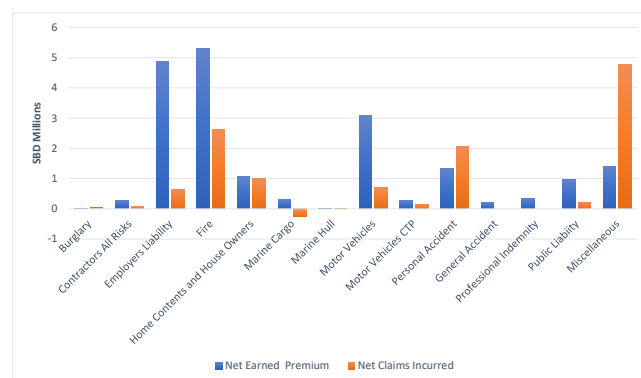
Portfolio by Class	\$ Millions		Percentage Change		Share	
	1H21	2H21	1H21	2H21	1H21	2H21
Burglary	0.092	0.039	475%	-58%	0.23%	0.13%
Contractors All Risks	3.333	0.655	-78%	-80%	8.35%	2.23%
Employers Liability or Workers Compensation	5.412	5.205	4%	-4%	13.57%	17.69%
Fire	14.767	10.655	-280%	-28%	37.02%	36.25%
Home Contents and House Owners	4.570	2.465	193%	-46%	11.46%	8.38%
Marine Cargo	0.550	0.354	28%	-36%	1.38%	1.20%
Marine Hull	0.018	(0.004)	-280%	-122%	0.05%	0%
Motor Vehicles	5.214	3.913	0%	-25%	13.07%	13.30%
Motor Vehicles (CTP)	0.924	0.429	470%	-54%	2.32%	1.46%
Personal Accident	1.055	1.494	-44%	42%	2.64%	5.08%
General Accident	0.183	0.273	-29%	49%	0.46%	0.93%
Professional Indemnity	0.573	0.186	226%	-68%	1.44%	0.63%
Public Liability	1.324	0.957	56%	-28%	3.32%	3.25%
Miscellaneous	1.879	2.791	-35%	49%	4.71%	9.49%
TOTAL	39.89	29.42	55%	-26%	100%	100%

Source: Central Bank of Solomon Islands

ants in the neighbouring countries and the social disorder in Honiara that combinedly negated the local economic performance. These ultimately strained the local insurance industry's overall growth performance. Total gross written premium (GWP) for the industry - despite higher than 2H2020, slumped by 26 percent from \$39.9 million in 1H21 to \$29.4 million over the last six months of 2021. Fire class remained the major contributor to the premium pool, posting \$10.6 million in GWP; followed by employer's liability which amounted to \$5.2 million; trailed by Motor Vehicle and CTP class which make up around 15 percent of the industry's GWP; while the remainder was shared by the other remaining classes (See table 2 on GWP Distribution). Incidentally, 'Contractors All Risk' notably declined, mainly due to subdued economic activity experience cumulative to end of 2H21.

In addition, the recent riots not only accelerated the weak economic condition but more so, it triggered an upsurge in claims, which cost the industry \$2.3 million (See Ap-

Figure 7: Insurance Sector Earned Premium Against Net Claims 2H21



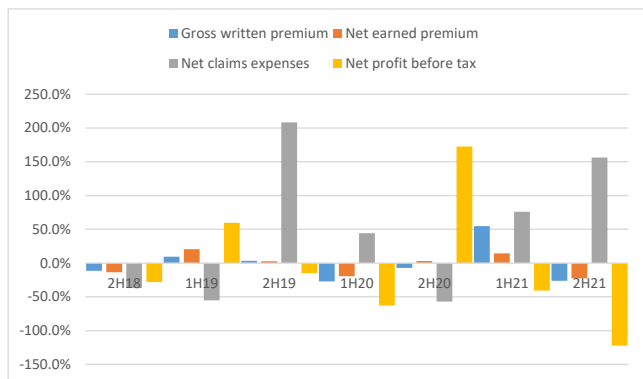
Source: Central Bank of Solomon Islands

back of the decline in bank deposits by 6.3 percent, which

⁶ Risk arising from riots, strikes and civil commotion

derived from higher claims payout during the period, followed by marginal declines in debt security and other assets by 0.5 percent and 10.3 percent, respectively. Nonetheless, the insurance sector managed to retain sufficient level of assets to cushion its liabilities at the end of 2021.

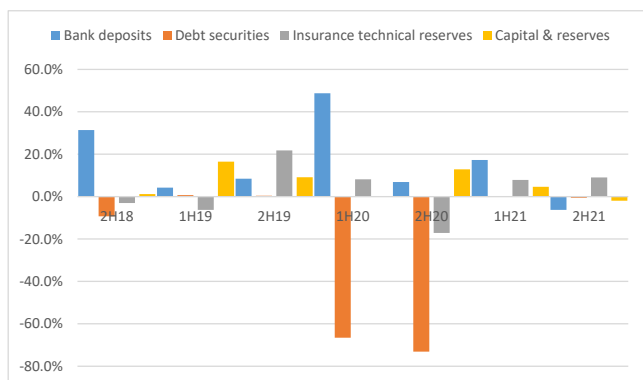
Figure 8: Insurance Sector Half Year Growth in Key Components of Income Statement, 2H18 – 2H21



Source: Central Bank of Solomon Islands

Furthermore, the industry’s total operating expenditures (Underwriting and Non-writing) contracted in 2H21, in tandem with the slowdown in economic activities. Total expenses slumped by 43 percent from \$13.8 million in 1H21 to \$7.8 million – decimating 10.3 percentage points in the sector’s expense ratio from 51.3 percent in the preceding period to settle at 41 percent in 2H21. The decline was mainly attributed to a drop in Head Office charges along with cutbacks in management expenditures.

Figure 9: Insurance Sector Half Year Growth in Major Assets & Liabilities, 2H18 – 2H21



Source: Central Bank of Solomon Islands

In terms of reinsurance, total reinsurance premium for the sector stood at \$10.3m million in 2H21, down from \$12.9 million recorded in the preceding period. On year-to-date basis, reinsurance cost has dramatically increased in 2021 compared to 2020. This pointed to a rise in reinsurance prices in the global reinsurance market. Reinsurance plays a crucial role in insurer’s risk management by facilitating the spread of insured risk across the global insurance in-

dustry thereby minimizing the domestic insurance industry’s exposure to catastrophic loss that would threaten its stability. Thus, maintaining prudent balance between local insurers’ risk appetite and exposure going forward.

In light of the sluggish performance witnessed over the last six months of 2021, the local insurance industry remained strong to persevere in the short to medium term. This was underpinned by adequate capital and asset quality maintained by the industry. Notwithstanding this, a prolong economic downturn will threaten the industry’s future stability. Hence, local insurers need to re-strategize in order to capitalize on cutting edges that are present within the unserved niche of the local insurance market. As it is worth noting that the local insurance market is still underserved mainly due to limited insurance product offering and the conservative approach undertaken by offshore insurers to service the local market due to very small premium return in contrary to the level of risks observed in Solomon Islands.

3.4: Credit Union Sector Performance

Although, the Credit Union sector displayed positive and steady performance in the last six months of 2021, it was not immune from the challenges posed by the COVID-19 pandemic. Revenue for the sector declined in 2H21 from \$1.5 million in 1H21 to \$1.2 million. The reduction in core activity of lending to members during the period suppressed the revenue, whilst operating cost moves the opposite direction recording a growth of 35 percent from 1H21, hence profitability ratios have declined accordingly. Although recording a declining trend in 2H21, the financial strength of the sector overall remains intact to protect the sector from uncertainties ahead.

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

4.1: Banking Sector Vulnerabilities & Risks

In 2H21, vulnerabilities and risks remain the same as the Government continued to employ mitigation measures to combat COVID-19 entry (See Table 5). For Banks, Credit Risks continued to bear a high-risk rating given the COVID-19 pandemic and its projected negative impact on asset quality coupled with the recent riots and the approved changes in the Solomon Islands Government (SIG) policy on public servants' rental entitlements. In essence, these risks would primarily affect borrower's repayment capacity over the medium to long term.

The Sector's Operational Risks also remained high in view of the high cost to income ratio within the Banks. Banks experienced unprecedented high costs as a result of COVID-19 pandemic and strategic responses employed to overcome pressing cost challenges. The work from home strategy triggered by COVID-19 has increased the cost of operation exorbitantly, an anticipated trend going forward. Overall, it is prudent for Banks to cautiously consider and ensure that cost reduction approaches work in harmony with the unusual challenges of the COVID-19 as a way forward.

4.2: Superannuation Sector Vulnerabilities & Risks

In spite of the superannuation sector's continuous resilience, vulnerabilities and downside risks to growth still exist and these could negatively impact the sector's stability in the medium to long term. The vulnerabilities in 2H21 includes COVID-19 presence and its impact on the economy, together with volatility in sovereign ratings and interconnections, and limited investment opportunities domestically.

The presence of COVID-19 virus locally and globally is a health-induced crisis with considerable economic consequences. COVID-19 exposes the Fund to credit risk and loss of confidence risk. Revenue sources from rental and dividend, including from fuel industry is anticipated to deteriorate in 1H22; subsequently increasing to medium, credit and investment risks rating, respectively. These risks could elevate further in 1H22 depending on various measures adopted by the government to manage COVID-19 transmission and the related health risks. Furthermore, prolonging these government measures, will likely put pressure on the sector's profitability and an enormous cost to the economy.

On the members' confidence front, the risk remains low. This amplifies the Fund's commitment to mitigate this risk through digitisation of some of its delivery channels to curb surge in members' withdrawals. Some of the digital channels used include (i) existing mobile and internet banking to directly deposit members contributions and rental payments into NPF bank account, (ii) use of

'youSave lo mobile' platform for savings and registering, (iii) email platform to send members contribution submissions and, (iv) NPF Apps which allow members to access their balances and statements.

The limited investment opportunities in the domestic environment remains to be a vulnerability to the sector; more so with the aging physical and legal infrastructures.

Rising membership and contribution have increased pressure on investment asset allocation strategy, intensifying concentration risk to a high rating and a medium rating default risk in view of limited domestic investment opportunities. However, efforts to sell shares particularly for South Pacific Oil Limited (SPOL) in 2021 had started with a hope to secure potential investors. The perceived risks however, is anticipated to rise further given the de-risking strategy practice to curtail excess exposures against the sector's capital.

Furthermore, sovereign ratings and interconnections also expose the Fund to sovereign and investment risks. The fall in capital in 2H21 was a clear evident of this where provisions on all assets were made to reflect deterioration in ratings across countries in which investments are domiciled. The risk edged higher to High rating in 2H21 from Medium in 1H21.

The probability of significant losses stemming from the key risks might not be eminent; but it is of paramount importance that existing controls are needed to be reviewed, enhanced and implemented. This is to ensure that members interests are protected, and their financial wealth continues to grow⁷ until retirement from the Fund.

4.3: Insurance Sector Vulnerabilities & Risks

The domestic insurance sector continued to grapple with the economic turmoil stemmed from the pandemic and the riot in Honiara, experienced during 2H21. The outcome further reinforced key vulnerabilities identified in 1H21. Thus, necessitates the importance for insurers to guard themselves against complacency and be upfront in their strategies. On top of that, susceptibility of property losses resulting from cataclysmic events and riots remained one of the key vulnerabilities for the insurance sector. This has led insurers to become more rigorous in carrying out their risk assessments while at the same time, being conservative in providing insurance cover for properties that are susceptible to such risks. In light of the threats relating to riots, some insurers have removed RSCC extensions from their product lines in order to alleviate their exposure to riot related loss. While others offered it on a case by case basis in order to retain strategically important customers, and at the same time preserve their market share. On a fur-

⁷ SINPF Corporate Objective 1 (<https://www.sinpf.org.sb/index.php/about-the-sinpf/our-corporate-philosophy.html>)

ther note, the continuous threat of properties losses coupled with uncertainties imposed by waves of COVID-19 variants, may potentially foster low morale that will diminish investors’ confidence. This will ultimately shroud the insurance sector’s long-term sustainability and future outlook. Thus, warranting strategic realignment.

On another note, the pandemic has also coerced insurers and brokers to leveraging technology, which brought about digital transformation to their operations. Despite this being an opportunity to advance the insurance market forward, technology also brought with it the risk of cyber security. Undoubtedly, these vulnerabilities and risks has the potential to disposition the insurance sector’s stability over time. Nevertheless, given the size of the sector compared to the banking and superannuation sectors, insurance sector still poses minimal risk to the broader financial system. Continuous supervisory actions are necessary to keep these risks and vulnerabilities at bay as some of these risk and vulnerabilities, despite minimal, can potentially develop into a systemic risk that can be contagious to other sectors and the broader financial system if left unchecked (See appendix 3.3).

4.4: Credit Union Sector Vulnerabilities & Risks

In 2H21, the unknown scale and duration of the COVID-19 pandemic coupled with the anxieties and uncertainties that come with it, represented an unprecedented risk to the macroeconomy. Accordingly, risks that contributed to the instability of the credit union sector were governance, credit and operational risks.

Unprecedented measures introduced in the country to tackle the pandemic gave rise for the credit unions to reduce services to members. Larger employee-based credit unions lost members due to laying off of staff and the government’s no job, no job policy.

Cyber security vulnerabilities and risks poses no direct threats to the credit union industry as most of them are still non-digitized. But risks to technology, systems failures and loss of critical data and information assets are eminent as most of the large credit unions do store their records electronically. The severity of such risks must not be taken lightly. In this context, securing of confidential data is important for credit unions thus having a reputable backup service provider and development of appropriate business continuity management strategies are paramount to ensure data are safely stored and business operations return to normalcy with a shortest possible time. In the meantime, the ongoing delay of the Credit Union Bill creates a gap for good governance and regulatory requirement. The credit union industry is desperately in need of this reform in order to align itself to best international practises.

The sector keeps at monitoring and maintaining operational stance and strategic directions in order to comply with regulatory requirements as well as enduring COVID-19 challenges. The Office of the Registrar for Credit Unions continues to work closely with the Credit Unions, particularly, the board and management to ensure good governance and comprehensible operational strategies are in place to remain resilient in the face of the pandemic and its economic impacts .

Table 6: Banking Sector Key Vulnerabilities and Risks⁸

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

Source: Central Bank of Solomon Islands

⁸ Risk ratings for past periods were updated following CBSI’s review of key risk indicators thresholds.

Table 7: Superannuation Sector Key Vulnerabilities and Risks

Vulnerabilities	Risk	Risk Description	2H20 Risk Indicator	1H21 Risk Indicator	2H21 Risk Indicator
COVID -19 travel restrictions, business protocols, digitisation of delivery channels, and uncertainties	Credit risk	Deterioration in rental payments	Medium	Low	Medium
		Deterioration in quality of loan portfolio	Low	Medium	Medium
	Loss of confidence	Surge in members withdrawal risk due to delays in service deliveries	Low	Low	Low
Sovereign ratings and interconnections	Sovereign and Investment Risks	Deterioration in returns and gains from equity investments	Low	Medium	High
Limited local investment environment	Credit concentration risk	Deterioration in quality of single equity and borrower	High	High	High

Source: Central Bank of Solomon Islands

Table 8: Insurance Sector Key Vulnerabilities and Risks

Vulnerabilities	Risk	Risk Description	1H21 Rating	2H21 Rating
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. Emails are also subject to malicious attacks.	Moderate	Low
Broad range of risk arising from changing weather pattern (Climate Risk).	Liquidity	Continuous changing weather pattern can lead to large catastrophic losses that could severely impact insurers underlying profitability and liquidity	Moderate	Low
Civil unrest	Profitability	Unpredictable political environment could lead to looting and burning of key businesses and infrastructures leading to non-renewal of policies from key customers which could affect sector's profitability.	Low	Elevated
Single insurer holding half of the insurance sector's total asset size	Market Concentration Risk	Deterioration in single insurer's financial capacity could significantly reduce industry's total assets.	Low	Low

Source: Central Bank of Solomon Islands

APPENDICES

Appendix 1 - Banking Sector

Appendix 1.1 Banking Sector Half Year Income Statement (\$Million)							
	<u>2H18</u>	<u>1H19</u>	<u>2H19</u>	<u>1H20</u>	<u>2H20</u>	<u>1H21</u>	<u>2H21</u>
Net interest income	123.1	122.0	123.8	118.6	120.6	113.0	113.7
Noninterest income	99.4	110.9	102.0	85.3	80.4	76.6	86.4
Noninterest expenses	116.3	122.3	125.4	115.0	116.1	110.6	106.5
Provision expenses	10.1	1.9	21.5	35.6	9.1	0.7	24.2
Net profit before tax	96.1	108.7	78.9	53.3	75.8	78.3	69.4

Appendix 1.2 Banking Sector Half Year Balance Sheet (\$Million)							
	<u>2H18</u>	<u>1H19</u>	<u>2H19</u>	<u>1H20</u>	<u>2H20</u>	<u>1H21</u>	<u>2H21</u>
Cash and deposits	2,718.8	2,623.2	2,510.7	2,610.2	3,065.7	3,143.1	3,293.7
Loans net of specific provisions for loan losses	2,383.5	2,454.1	2,479.1	2,447.9	2,511.7	2,484.8	2,515.7
Debt securities	773.8	782.9	782.1	703.1	474.1	471.5	476.7
Nonfinancial assets	178.1	198.2	200.2	212.0	216.2	206.1	286.5
Total Assets	6,131.8	6,144.0	6,070.2	6,083.3	6,367.9	6,397.5	6,685.4
Currency and deposits	4,926.5	4,880.8	4,790.8	4,772.5	4,939.0	5,012.6	5,133.5
Other Liabilities	191.3	259.7	234.6	245.8	265.1	234.5	316.1
Capital and reserves	1,014.1	1,003.5	1,044.8	1,065.0	1,163.9	1,150.4	1,235.9
Total Liabilities & Capital	6,131.8	6,144.0	6,070.2	6,083.3	6,367.9	6,397.5	6,685.4

Appendix 1.3 Half yearly Loans and advances by key sectors (\$Million)							
	<u>2H18</u>	<u>1H19</u>	<u>2H19</u>	<u>1H20</u>	<u>2H20</u>	<u>1H21</u>	<u>2H21</u>
Manufacturing	149.4	134.1	119.0	120.5	105.0	106.4	127.6
Forestry	60.4	52.7	75.9	70.4	103.5	74.8	96.1
Fishing	6.8	23.8	11.3	8.8	8.2	2.9	8.6
Distribution	496.0	536.7	558.5	593.1	588.6	603.1	612.1
Communication	133.0	98.5	83.0	81.3	80.3	64.3	86.5
Personal	620.4	635.6	695.3	698.0	676.5	690.4	922.5

Source: Central Bank of Solomon Islands

Appendix 2: Superannuation Sector

Appendix 2.1 Half Year Profit and Loss Statement of Superannuation sector (\$Million)							
	<u>2H18</u>	<u>1H19</u>	<u>2H19</u>	<u>1H20</u>	<u>2H20</u>	<u>1H21</u>	<u>2H21</u>
Interest income	40.1	167.9	30.8	150.8	29.8	121.5	35.1
Noninterest Income	1.8	248.0	15.6	-90.9	-10.9	52.0	209.3
Noninterest Expenses	50.5	46.3	37.7	44.9	37.8	40.0	47.9
Interest payable to Members	33.3	20.7	36.6	15.2	2.4	2.7	3.6
Net surplus/(Deficit)	-30.0	348.9	-28.0	-0.0	-21.3	130.8	192.9

Appendix 2.2 Half Year Balance Sheet Statement of Superannuation Sector (\$ Million)							
	<u>2H18</u>	<u>1H19</u>	<u>2H19</u>	<u>1H20</u>	<u>2H20</u>	<u>1H21</u>	<u>2H21</u>
Demand deposits	192.3	215.5	158.6	167.0	218.9	260.6	180.3
Time deposits	711.1	721.8	747.4	642.6	600.9	601.3	612.4
Loans	140.6	124.5	111.6	150.6	111.0	134.2	119.5
Debt securities	206.6	218.9	228.0	264.3	251.1	257.1	322.5
Shares and equities	1651.4	1894.1	1907.0	1745.2	1779.8	1835.9	2077.6
Accrued interest & dividend receivables	31.0	25.6	13.7	39.3	39.4	11.1	8.7
Non-financial assets	500.6	608.9	631.5	680.5	692.1	698.6	711.5
Other assets	34.5	31.6	32.0	44.5	34.3	34.4	40.4
Total assets	3486.0	3840.9	9	3734.1	3727.4	1	4072.9
Members contributions	2992.0	2998.4	3272.9	3154.6	3294.2	3285.7	3493.6
Other Liabilities	100.6	115.5	98.6	117.9	89.4	87.3	97.5
Capital & reserves	372.6	722.6	458.3	459.6	343.8	460.2	481.8
Total liabilities & capital	3468.1	3840.9	3829.9	3734.1	3727.4	3833.1	4072.9

Source: Central Bank of Solomon Islands

Appendix 3: Insurance Sector

Appendix 3.1 Half year Income Statement (\$Million)							
	2H18	1H19	2H19	1H20	2H20	1H21	2H21
1. Gross Written Premium	33.5	36.7	38.0	27.7	25.8	39.9	29.4
2. Outward reinsurance	15.0	9.9	11.7	7.6	4.6	12.9	10.3
3. Premium net of reinsurance (= 1 - 2)	18.5	26.8	26.3	20.1	21.2	27.0	19.1
4. Unearned premium reserves	-2.9	1.1	-0.1	-1.3	-0.8	1.8	-0.3
5. Net earned premium (= 3 - 4)	21.4	25.7	26.5	21.3	22.0	25.1	19.5
6. Gross claims expense	2.4	2.2	6.9	10.5	2.6	6.2	18.1
7. Total recoveries	-0.7	0.8	2.6	4.3	0.0	1.5	6.0
8. Net claims expenses (= 6 - 7)	3.1	1.4	4.3	6.2	2.7	4.7	12.1
9. Acquisition Costs	0.1	-0.1	0.1	0.2	0.2	-0.1	0.1
10. Total underwriting expenses	10.1	8.2	12.3	13.7	9.6	11.8	18.6
11. Underwriting Results (= 5 - 10)	11.3	17.5	14.2	7.7	12.3	13.3	0.8
12. Investment income on assets backing insurance liabilities	0.3	0.3	0.3	-0.7	0.4	0.1	0.3
13. Insurance Results (= 11 + 12)	11.6	17.8	14.6	6.9	12.7	13.4	1.1
14. Other operating expenses or management expenses	4.2	5.9	4.4	3.2	2.4	7.3	2.4
15. Net Profit (Loss) Before Tax (= 13 - 14)	7.5	12.0	10.2	3.8	10.3	6.1	-1.4
16. Income tax or provisions	2.9	3.7	3.4	1.1	3.0	1.6	1.0
17. Net Income (Loss) End of Current Period (=15 - 16)	4.6	8.3	6.8	2.7	7.3	4.5	-2.3

Appendix 3.2 Half-year Balance Sheet (\$Million)							
	2H18	1H19	2H19	1H20	2H20	1H21	1H21
18. Total Assets (= 19 + 20)	138.5	145.8	157.0	167.5	168.1	197.7	192.1
19. Nonfinancial assets	2.1	2.1	4.5	4.1	4.4	6.0	7.9
20. Financial assets (= 21 to 25)	136.5	143.7	152.5	163.3	163.7	191.6	184.2
21. Currency and deposits	65.0	67.8	73.5	109.4	116.9	137.1	128.5
22. Loans	-	-	-	-	-	-	-
23. Debt securities	47.3	47.6	47.8	16.0	4.3	4.3	4.3
24. Insurance technical reserves	23.2	26.3	29.1	36.5	40.9	46.5	48.1
25. Other assets	0.9	2.0	2.0	1.5	1.6	3.7	3.3
26. Liabilities (= 27+ 28)	83.2	81.4	86.6	96.9	88.5	114.3	110.3
27. Insurance technical reserves	69.3	65.0	79.2	85.6	71.0	76.5	83.5
28. Other liabilities	13.9	16.4	7.4	11.3	17.5	37.8	26.9
29. Capital and reserves	55.3	64.5	70.4	70.6	79.6	83.3	81.8
30. Balance Sheet Total (= 26+ 29 = 18)	138.5	145.5	157.0	167.5	168.1	197.7	192.1

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

Source: Central Bank of Solomon Islands

Appendix 4: 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 stable micro-financial conditions with minimal threat to financial stability
Medium	Signals moderate levels of systematic risk build up that suggest the need for closer monitoring but not an immediate policy response
High	Indicates potentially disruptive levels of systematic risk to the point where policy intervention should be seriously contemplated
Extreme	Denotes that materialization of systematic risk is imminent with a significant threat to the real economy which requires immediate policy intervention

Source: Central Bank of Solomon Islands

