



BELIZE

BELIZE – SELECTED ISSUES

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Glossary

AML/CFT	Anti-Money Laundering and Combating the Financing of Terrorism
APSSS	Automated Payment and Securities Settlement System
AQRs	Asset Quality Reviews
CAR	Capital Adequacy Ratio
CARTAC	Caribbean Technical Assistance Centre
CBB	Central Bank of Belize
CBR	Corresponding Banking Relationship
CFATF	Caribbean Financial Action Task Force
CFZ	Commercial Free Zone
DFC	Deposit Finance Corporation
FATF	Financial Action Task Force
FDI	Foreign Direct Investment
FSR	Financial Stability Report
FSAP	Financial Sector Assessment Program
FIU	Financial Intelligence Unit
FX	Foreign Exchange
GDP	Gross Domestic Product
IBC	International Business Company
IFSC	International Financial Services Commission
ML/TF	Money Laundering/Terrorism Financing
MTB	Money Transfer Business
NPLs	Non-Performing Loans
NPS	National Payments System
NRA	National Risk Assessment

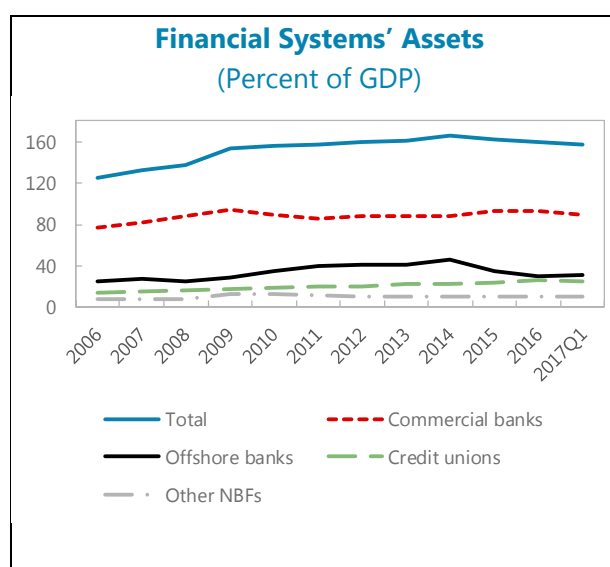
RECENT DEVELOPMENTS IN BELIZE'S FINANCIAL SYSTEM

A. Introduction

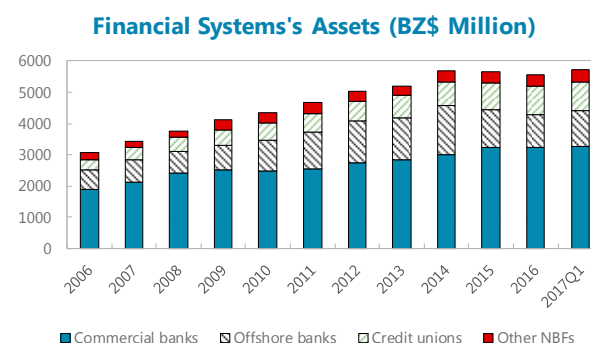
1. **This note takes stock of recent developments in Belize's financial system.** The financial system remains sizable, at 157 percent of GDP in March 2017. The resilience of the banking system continues to slowly strengthen, in part because of the authorities' resolve to maintain a sound and stable financial system.
2. **The importance of macro-financial linkages justifies their continuous monitoring, not only for financial stability but also for overall macroeconomic stability.** Both domestic and international banks play important roles in mobilizing savings for domestic investment and in facilitating external trade, on which the small open economy of Belize strongly depends. Both also extend significant credit to the economy.
3. **Belize is recovering from significant loss of correspondent banking relationships (CBRs).** Correspondent banks terminated over two-thirds CBR accounts of banks in less than a year, from mid-2015 to early 2016. Of the ten banks licensed in Belize, only a Canadian bank has not lost any CBRs, while the recently established state-owned bank does not yet have one. The CBR withdrawal pressure has eased somewhat since the second half of 2016, as all affected banks found some replacements CBRs and alternative ways of processing cross border transactions.
4. **Remaining financial system vulnerabilities, including CBR withdrawal, will require close monitoring.** The banking system NPL ratio should further be reduced to below the 9.8 percent (2.2 percent net of provisions) recorded at end-March 2017. The reported capital adequacy ratio (CAR) is stable at 23 percent, but weak capital buffers and insufficient provisioning in some banks reduce loss absorption capacity. So far, the macroeconomic impact of the loss of CBR has been limited, in part because of the collaborative efforts of banks and the authorities. Further progress is needed in addressing the underlying drivers of the CBR losses, including Money Laundering and Terrorism Financing (ML/TF) risks mostly related to the weak regulation and supervision of the non-bank offshore sector and the lack of entity transparency. Some of the new CBRs are fragile, and further losses could affect the economy and banks' balance sheets. The macroeconomic outlook is still weak, and risks to debt sustainability remain high, despite the recent restructuring of public debt to private external bondholders.
5. **The remainder of this note is organized as follows.** Section II gives an overview and recent developments in the financial system. Section III reviews banks' balance sheets developments, and section IV takes stock of the evidence of withdrawal of correspondent banking relationships. Section V discusses specific policy options to address financial system challenges, and concluding remarks are presented in section VI.

B. Financial System: Overview and Recent Developments

6. **Financial system assets remain sizable (Table 1).** At end-March 2017 domestic banks' assets amounted to BZ\$3.2 billion, equivalent to 90 percent of GDP, broadly unchanged since December 2015. The assets of international banks (offshore) recovered slightly to BZ\$1.1 billion (31.2 percent of GDP) in the first quarter of 2017, after declining in 2015 and 2016 from a peak of BZ\$1.6 billion (46 percent of GDP) in December 2014. Credit unions continue to grow robustly, accounting for 16 percent of financial system's total assets. The domestic insurance sector and the state-owned Deposit Finance Corporation (DFC) together hold 7 percent of the system's assets.



7. **The financial intermediation role of offshore banks has declined in recent years.** Offshore banks receive deposits in foreign currency from non-residents, and lend to foreign investors, and domestic businesses, mostly in the real estate and tourism sectors. Reflecting the loss of CBRs, the proportion of offshore bank's assets (26 percent), deposits (24 percent), and capital (27 percent) in the banking system total, declined by 9 percent, 10 percent, and 5 percent, respectively, in March 2017, relative to December 2014. Their share of loans (21 percent) is stable due to substantial lending by the only offshore bank that was largely unaffected by the withdrawal of CBR. Domestic commercial banks and credit unions have stepped up their financial intermediations roles.



8. **The Central Bank of Belize (CBB) is committed to securing financial system soundness.** It conducted 5 on-site examinations in 2016, including 3 full-scope examinations for 2 domestic banks, and 1 credit union. Assisted by CARTAC, the CBB has revamped its Financial Stability Report (FSR), first published in March 2014. The FSR covering 2015-2016 has been completed. Stress testing techniques have been enhanced, and now include forward looking models. The CBB is laying the groundwork for Basel II implementation. Furthermore, the Moneylenders legislation was amended by parliament in December 2016, with an effective implementation date of April 2017, to (i) modernize the regulatory regime in accordance with international standards; (ii) enhance supervisory and enforcement powers; (iii) allow for greater transparency in the licensing process; and (iv) ensure the application of fit and proper standards in the sector. Under this new regime, the CBB has been given supervisory responsibilities that were previously assigned to the Ministry of Finance. Legislation has

been amended to bring the supervision of the offshore insurance sector under the authority of the Office of the Supervisor of Insurance.

9. **With limited capacity, the CBB continues conducting AML/CFT supervision.** In 2016, the CBB conducted AML/CFT inspections of three banks and two credit unions. Where deficiencies were detected, the CBB requested time bound remedial actions, but did not impose any sanctions. The CBB continues developing its risk based tools but lacks sufficient qualified AML/CFT supervisors to properly supervise financial institutions under its purview.

10. **The overall regulation and supervision of the non-bank offshore sector is still inadequate.** In 2017, the International Financial Service Commission (IFSC) increased the capital requirements for financial service providers and registered agents and trust services it licenses which led to a drop of around 11 percent of licensed operators (see Table 3). Financial service providers are not required to have physical presence in Belize so it is not possible to supervise them. Registered agents and trust services involved in the creation of companies, foundations, and trusts are not properly regulated to ensure that they hold the beneficial owners' information they are involved in creating, and are not properly supervised by the IFSC (in 2017, only 2 registered agents and 2 trust services were inspected).

11. **The authorities are in the process of requiring agents involved in creating entities (companies, foundations and trusts) to make the beneficial owners' information available in a timely manner.** The International Business Companies Act (IBC) is under review to require registered agents to make beneficial ownership information available in their premises. The amendments are expected to be adopted by the Parliament in July. However, similar amendments have not yet been introduced to other types of entities (Limited Liability Companies, foundations, and trusts). Moreover, the IFSC is not properly inspecting those agents for compliance.

12. **An ML/TF National Risk Assessment (NRA) is ongoing.** This exercise, the first in Belize, is led by the National Anti-Money Laundering Committee, and coordinated by the Financial Intelligence Unit (FIU). The NRA will assist in identifying the high-risk sectors and business activities, and help in allocating resources to mitigate risk exposure. With the support of the IADB, an expert was brought in from the FIU of Trinidad and Tobago to assist for 6 months. The authorities are also receiving technical support from the US Treasury to improve the capacity of the FIU. The NRA report—part of the preparation for the Fourth Round of the Caribbean Financial Action Task Force (CFATF) Mutual Evaluation, scheduled for 2021—is expected to be completed in 2018.

13. **Modernization of financial system infrastructure has advanced steadily.** In October 2016, the authorities launched the Automated Payment and Securities Settlement System (APSSS), a critical part of a modern national payment system (NPS) of Belize. In February 2017, accompanying laws to govern the NPS were passed by parliament. The APSSS, a state-of-the-art payment infrastructure, will facilitate large and small payments and permit electronic auction and registration of government papers. With this new infrastructure, fund transfer and check clearing by banks and other authorized

financial institutions is expected to be faster, safer and more reliable, thereby enhancing the ease of doing business. The NPS reform, a collaborative effort involving the authorities and domestic banks, has been ongoing for several years, and entails a comprehensive modernization of laws governing electronic payments, robust information technology infrastructure, and a supportive operating environment to enhance the quality of transactions and payments in Belize.

C. The Current Strength of Banks' Balance Sheets

14. **The strength of bank balance sheet is improving.** Financial sector reforms implemented since the 2011 FSAP continue to bear fruits. The stock of gross NPLs in the banking system fell to 9.8 percent of total loans at end-March 2017 (2.2 percent net of provisions), from 15.8 percent (5.7 percent net of provisions) a year ago, due mainly to loan write-offs by banks and restructuring by a major bank. The reported capital adequacy ratio (CAR) is stable at 23 percent. The banking system remains amply liquid, with liquid assets exceeding the mandatory requirement. Profitability ratios are slowly improving as banks fully comply with provisioning requirements for legacy loans.

Financial Soundness Indicators 1/ (Domestic and International Banks; in percent)										
	2008	2009	2010	2011	2012	2013	2014	2015	2016	Mar-17
Capital/risk-weighted assets 2/	20.4	22.2	23.9	24.2	19.8	21.6	21.7	20.5	22.1	23.3
Capital/total assets	15.6	16.5	16.5	14.7	11.6	12.0	12.1	13.5	13.7	13.3
Excess statutory liquidity 3/	30.1	33.5	43.8	64.3	83.5	79.1	84.4	80.2	73.4	78.6
NPLs/total loans	11.7	14.0	18.7	21.4	20.3	17.6	15.7	15.8	11.9	9.8
Provisions/NPLs	24.1	18.1	15.5	24.4	34.9	42.8	55.1	57.6	72.4	71.3
Provisions/total loans	2.8	2.5	2.9	5.2	7.1	7.5	8.7	9.1	8.6	7.0
NPLs net of provisions/capital	40.0	48.2	61.9	66.1	63.6	46.5	30.8	27.4	14.2	11.9
Return on Assets After Tax	0.1	0.2	0.2	0.1	-0.1	0.1	0.9	-0.2	0.2	0.5
Memorandum items:										
Capital/risk-weighted assets 4/	...	...	...	...	...	20.4	20.9	23.3	21.3	21.2
NPLs net of provisions/capital 4/	...	...	...	...	...	46.5	33.4	25.5	14.5	14.2
Sources: Central Bank of Belize; and Fund staff estimates.										
1/ Includes BZ\$36 million disputed LCIA award to Belize Bank Ltd.										
2/ The required CAR for domestic and international banks are 9 percent and 10 percent, respectively.										
3/ In percent of statutory liquidity requirement.										
4/ Excludes BZ\$36 million award by the LCIA.										

15. **A major bank’s NPL ratio declined sharply following loan write off and a recent restructuring of a legacy loan.** Its ratio of gross non-performing loans (NPLs) declined to 8.1 percent (0.5 percent net of provisions) at end-March 2017, from 28.6 percent (13.5 percent net of provisions) a year ago. This primarily reflects loan write-offs BZ\$78.3 million and restructuring of legacy loans BZ\$28 million.

Its CAR was 14.9 percent compared to 15.1 percent at end-March 2016, partly because of high provisioning expenses, loan write-offs and losses recorded. Taking into account the disputed government assets (BZ\$36

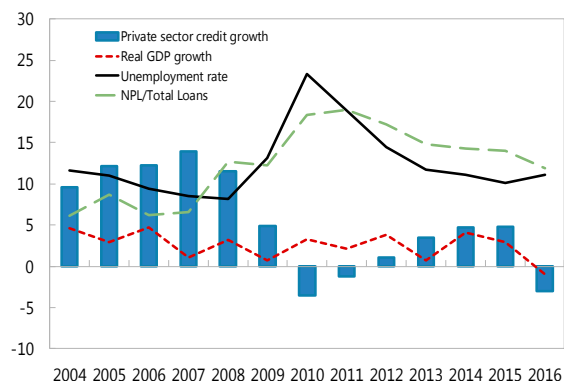
Banking System Loan Write-off, 2011-2017							
	2011	2012	2013	2014	2015	2016	2017Q1
Domestic Banks							
BZ\$ Million	43.3	37.8	52.7	22.0	32.5	52.8	54.9
percent of assets	1.7	1.4	1.9	0.7	1.0	1.6	1.7
International banks							
BZ\$ Million	0.0	7.2	10.9	6.4	6.3	25.2	0.8
percent of assets	0.0	0.6	0.8	0.4	0.5	2.4	0.1

million) on the bank’s balance sheet, CAR falls to 7.8 percent, below the statutory requirement of 9 percent. A capital injection of about BZ\$6 million would be needed to bring the CAR up to the requirement.

16. **The NPL ratio of the recently established state-owned bank has deteriorated.** The bank’s gross NPL ratio spiked to 45.5 percent (25.5 percent net of provisions) in December 2016, from less than 1 percent (-0.6 percent net of provisions) in December 2015. Its CAR stood at 109.2 percent, supported by financing from Petrocaribe resources (BZ\$35 million). Its loan portfolio expanded from BZ\$0.7 million in December 2013, three months after it started business, to BZ\$39 million in March 2017. The loans were for residential construction and real estate, in line with the banks’ mandate to provide affordable mortgage credit for first time home owners, particularly teachers and public officers. Its assets amounted to BZ\$52 million, about 1.6 percent of the banking system total. Findings from onsite inspection by the Central Bank in November 2016 indicate that the dramatic deterioration in credit quality is due primarily to system configuration error associated with transition from manual methodology to a new core banking software, although weaknesses in lending practices were evident. The bank has been under enhanced supervision since the onsite inspection, and a comprehensive review of its loan portfolio is ongoing, as directed by the CBB. At end March 2017, the NPL ratio decreased to 25 percent, following reclassification of large NPLs after an initial review by the bank. The bank has also revised its lending policies and procedures. A follow up onsite inspection due in June 2017.

17. **Weaknesses in banks’ balance sheets, including high NPLs and low capital buffers, have held back private credit growth.** After turning negative in 2010, when NPL ratios reached their peak, credit growth started to recover, but then contracted in 2016, despite abundant liquidity in the domestic banking system. While the impact of the high stock of NPLs on economic activity appears muted somewhat as real GDP growth has been stable, banks’ balance sheets

Selected Macro-Financial Indicators (percent)



Sources: Central Bank of Belize; IMF Staff calculations

have been weighed down by NPLs, loan write-offs and increased provisioning.

18. The banking system has maintained a manageable exposure to the government.

Government securities, consisting of treasury bills and treasury notes held by three domestic banks were BZ\$254 million, equivalent to 7.8 percent of total assets of the domestic banking system, and 7.3 percent of total public debt in December 2016. One domestic bank holds about half of government debt to the banking system.

19. Impediments to NPL resolution remain, including those identified by the 2011 FSAP. These include inconsistent collateral valuation, information gaps, a lengthy liquidation process, and an illiquid real estate market. Belize does not have a collateral registry and weaknesses persist in the land registry system. The supply of other forms of collateral, beside real estate, is severely limited, given the small stock of marketable government securities and an underdeveloped capital market. Overall, there are significant gaps in the information/data framework: (i) there is no formal credit bureau and banks depend on a private bureau with voluntary participation; and (ii) there are no public registers for movable property and for real estate transactions. There are also weaknesses in debt enforcement and the insolvency regime as it takes a long time to resolve a corporate insolvency, which lengthens time needed to resolve corporate NPLs.

20. Stress tests indicate that the banking system is becoming more resilient. Under the baseline scenario, which did not assume any potential direct impact from the loss of CBRs on banks as they were assumed to find workarounds, the most recent analysis indicated that no bank would see their CARs fall below the regulatory minimum. In a similar exercise conducted earlier (during the 2015 Article IV Consultation), a few banks were found to have their CAR fall below the regulatory minimum under the baseline. Under high stress, the banking system was reported have capital shortfalls for two years, as some banks remain weak, particularly a major bank. Vulnerability to credit risk, including related party transactions and loan concentration, lingers. The loss of CBR has heightened liquidity risks in international banks. The largest credit union was found resilient to a severe shock.

21. Nonetheless, key vulnerabilities persist. The loss of CBRs remains a challenge in Belize, and some newly established CBRs appear fragile. Moreover, despite the recent debt restructuring, the level of public debt remains elevated. Since government securities represent a non-negligible share of banks' portfolios, losses on government securities would reduce the capital buffers of banks. Some domestic banks, including the largest one, which is of systemic proportions, still have low capital buffers and raising new capital to avoid a deterioration of their capital adequacy ratios has been a challenge, raising the prospect that the public sector might have to intervene.

D. Withdrawal of Correspondent Banking Relationships in Belize

Evidence and Recent Developments

22. **The termination of CBRs in Belize reached a significant scale in early 2016.** Major global banks terminated over two–third CBR accounts in the banking system in less than a year, from April 2015 to February 2016. In June 2016, domestic banks had 6 CBR accounts by major currency compared to 37 accounts three years earlier. Most of the lost CBRs accounts were denominated in US dollars, reflecting the importance of US dollar transactions in Belize. Of the ten banks, only a Canadian bank has not lost a CBR, while the recently established state-owned bank does not yet have one.

Domestic Banks CBR Maintained by Major Currency					
	Jun-13	Jun-14	Jun-15	Jun-16	May-17
USD	14	11	9	4	7
GBP	9	9	6	1	3
EURO	6	6	4	1	3
CAD	5	5	4	0	1
Others 1/	3	3	3	0	0
Total	37	34	26	6	14

Source: Central Bank of Belize
1/ AUD, CHF, and JPY

23. **Two foreign owned banks—one Canadian domestic and one US offshore—managed to maintain at least one CBR with full banking services.** Together, they account for 27 percent of the banking system’s assets. The Canadian bank is the second largest domestic bank, while the offshore bank is the largest in the offshore banking sector. Some banks managed to maintain wire transfer arrangements, including with nonbank payment services providers.

24. **The largest, indigenous bank lost all its CBRs.** This bank, which accounts for 22 percent of the banking system’s assets (26.5 percent of GDP), later secured a credit card settlement account with a small U.S. bank, and a costly wire transfer arrangement with a European bank, which were soon terminated. At the peak of this problem, the bank operated without a CBR for 4 months.

25. **Withdrawal decisions of global banks also affected the CBB.** The CBB lost two of its five CBRs due to low volume of business. One of the lost CBRs was being used to temporarily process selected wires for commercial banks following termination of their CBRs.

26. **A prominent, first tier U.S. and a European bank were the main providers of correspondent banking services.** The U.S. bank, which exited Belize at a short notice, offered full banking services to 8 banks (for up to 30 years in one bank), in three major currencies—USD, British Pound and Euro. Similarly, the European bank provided full banking services to 7 banks, in four major currency including Canadian Dollars. All offshore banks except one had CBR accounts with both correspondent banks only.

27. **The offshore banking sector was particularly hard hit.** The sector lost about 80 percent of CBR accounts. As a result, offshore banks have scaled down their operations, while domestic banks now play a greater role in the banking system. As of March 2017, the largest offshore bank that has a CBR with full banking service controls 27.5 percent of the offshore sector’s total loans, 39.1 percent of assets, 42.7 percent of total deposits and 21.9 percent of capital.

28. **Despite the termination of CBRs, all banks were still able to process credit card transactions using their accounts with major credit card companies.** Until February 2016, four banks, including the largest bank, had restricted bank accounts with a small U.S. bank, which were used to manage proceeds from their credit card transactions. After this arrangement was cut off, the

proceeds were used either through accounts with credit card networks, or through other restricted accounts such as brokerage accounts.

29. To protect their CBRs, some banks have terminated their relationships with clients from certain sectors perceived as high risk. Banks have refused to process incoming and outgoing wire transfers of credit union members because the business segment is considered a ‘nesting’ arrangement, which has been prohibited by some correspondent banks. Generally, money transfer businesses (MTBs) are considered high risks, and for that reason, many domestic banks have closed accounts of MTBs. The largest bank decided to close all accounts of MTBs, casinos and Commercial Free Zone (CFZ) operators, upon receiving termination notice for a CBR that it had maintained for 30 years. At one bank, wire transfers for Western Union agents could only be processed through one correspondent bank as the other correspondent banks had warned that wire transfers of MTBs would not be processed. Consequently, the bank is not establishing any new accounts for MTB agents. Another bank terminated the main business account of a major MTB agent simply because of its involvement in money remittance business. Difficulties in maintaining accounts with domestic banks has forced several sub-agents of MTBs to shut down their businesses. Some banks have also stopped processing wire transfers to international suppliers for importation of cigarettes for any entity in the free zone. The only domestic bank offering services to the CFZ has placed restrictions on USD deposits from the zone, increasing cash holding outside the banking system. Banks reported that they have closed accounts of IFSC-licensed financial services with no physical presence in Belize, and most of the entities created in the offshore center.

30. After an intensive, costly search for replacements, Belizean banks recovered CBRs in late 2016. Two domestic banks established a CBR with a UK bank in September 2016. The largest domestic bank has recovered two CBRs, one in October 2016, with a small Puerto Rican Bank, and another one in December with the same UK bank that is offering service to other banks. Finding replacements has been very difficult and costly. The largest bank indicated contacting about 250 banks, mainly in the US, without being able to establish a new CBR. Presently, all affected banks in Belize have CBRs but the new ones are wire arrangements with small, less known banks and non-bank payment service providers. The major provider of the new CBRs, a UK bank, is an intermediary between Belizean banks and a major US Bank. This correspondent bank is reported to have recently established presence in the Caribbean, and Africa, taking advantage of the loss of CBRs across these regions. It provides AML assurance to the major US banks, including through onsite inspections of respondent banks. At one point, some local banks considered acquiring a small US-licensed bank, but they refrained from doing so after studying the cost and benefits of such an initiative. Global banks that left Belize have not returned. While no bank has lost a CBR since June 2016, vulnerability to additional CBR losses has not waned.

Drivers

31. Globally, the factors leading to global banks’ withdrawal from CBRs are multiple and interrelated and their relative significance varies across countries (see IMF 2017). The withdrawal of CBRs reflects banks’ business decisions based on their assessments of the profitability and risk of the relationship. These assessments have been shaped by the changing regulatory and supervisory

enforcement environment after the global financial crisis and the resulting increases in overall compliance costs. In certain instances, the increased costs and correspondent banks' concerns about their ability to assess and manage CBR risks may lead them to terminate their relationships with specific respondent banks, countries or even regions.

32. In Belize, the loss of CBRs is likely related to the low volume of transactions combined with the provision of offshore financial services that heightens ML/TF risks and global banks' perception that some banks in Belize are unable to properly mitigate those risks. Some customers (e.g., licensed financial services with no physical presence, and entities with complex structures), business lines, markets and jurisdictions are evidently being perceived as too risky and costly in terms of compliance, and are therefore being cut off. A major European bank that exited Belize in April 2016 was reported to have cited deficiencies detected by its compliance department in Belize's regulatory framework in relation to AML/CFT. However, in other termination notices, major correspondent banks have not provided specific reasons for the termination of the relationships.

33. Although Belize exited from the CFATF follow-up process in May 2015 for upgrading its AML/CFT legal framework, implementation is still inadequate. The supervisors lack sufficient capacity to properly inspect financial institutions especially those licensed in the offshore sector. Regulation and supervision of trust and company service providers is weak mainly due to limited resources. Furthermore, the beneficial information of legal persons and arrangements is not always available or up-to-date. The Financial Intelligence Unit is upgrading its systems to effectively process the analysis of suspicious reports and disseminate them to law enforcement agencies. The system is not yet leading to effective prosecution, and convictions of money laundering or confiscation of illegal assets.

34. ML/TF risks related to the misuse of legal persons and arrangements in the offshore business sector could be significant. The regulator for the non-bank offshore sector—the International Financial Services Commission (IFSC)—offers, through a high number of registered agents and their intermediaries abroad, the services of establishing complex entities without a proper mechanism to have the related beneficial ownership information available, accessed, and disseminated in a timely manner. The agency also licenses service providers (e.g. FX, insurance, trading) without the requirement to have a presence in Belize. While these services generate relatively low fiscal revenues, their lack of transparency and the possibility for them to hold accounts in offshore banks seem to create significant reputational risks for Belize. These issues are receiving the authorities' attention, and they have started to address them, including through stricter licensing requirements and amendment to legislation to require beneficial ownership information to be maintained in the premises of registered agents, and by abolishing bearer shares.

Impact

35. Foreign exchange market data indicate a moderate decline in cross-border receipts and payments in 2016 (Figures 1-2). Domestic banks foreign exchange inflows (proceeds) and outflows (payments) fell by 4.0 percent and 2.4 percent respectively in 2016. Inflows relating to drafts, wire transfers, and travelers cheques, which accounted for about half of total inflows, declined by 2.5 percent, compared to 2015. Outflows for these instruments (71 percent of total outflows) also declined

by about 7 percent. On the other hand, credit card inflows (29 percent of total) increased by 6.4 percent, following an increase of 8.5 percent in 2015, while credit card outflows (18 percent of total) rose by 18.7 percent and 15.8 percent in 2016, and 2015, respectively.

36. **The cross-borders flows of one domestic bank were severely hampered (Figure 1-2).** Total inflows and outflows of that bank declined by 31.5 percent and 29.7 percent, respectively in 2016 and 2015, mainly reflecting inability to process wire transfers.

37. **The impact of the loss of CBRs so far is reflected in higher transactions cost, lengthy processing times, limited access to financial services, and increased cost of due diligence.** The loss of CBRs led to restricted access to financial services of certain customers and business lines, delays in international payments and remittances, and higher transaction costs and cost for due diligence. The largest bank has indicated having increased wire transfer fees from about US\$100 to US\$300, reflecting the cost of maintaining its wire transfer arrangement. The processing time for wire transfer was reported to have also increased from “within twenty-four hours” to “several days.” Even with the recently acquired CBRs, the cost of wire transfer and processing time for that bank remains high. The bank indicated only being able to process 6–8 wires daily, while processing times takes a few days, partly reflecting tedious manual processes and extremely burden AML/CFT scrutiny. For this bank, regaining access to cross-border financial services has come at a high cost, as one of its new arrangements entails an annual service fee of US\$140,000.

38. **Staff’s updated estimates under an illustrative low stress scenario indicate that the impact of losses of CBR on trade flows could be limited, but could be sizable on some banks’ balance sheet.** The “low stress” scenario assumed that loss of CBRs reduces the value of cross-border transactions by 10 percent. In that context, real GDP could drop by about 1 percentage point every year relative to the baseline with no CBR challenges during 2017–21. Exports could fall by about 3.3 percentage points of GDP, imports by about 3.5 percentage points of GDP, and FDI by about 0.4 percentage point of GDP. The banking system’s CAR could fall by close to 3.5 percentage points but would remain above prudential minimum of 9 percent, though some banks’ CARs could fall to close to the prudential minimum.

39. **The impact of the loss of CBRs has been partly contained because of measures taken by Belizean authorities and banks.** Some customers of the affected banks moved to banks that still have CBRs with full banking services. Anecdotal evidence suggests that some banks are using less transparent workarounds, to send money abroad. Some banks continued to offer higher credit limits up to US\$50,000 on the credit cards they issue, which would allow some businesses to send their money out of Belize. International financial transactions have not been disrupted as initially feared due to support from CBB and major credit card companies. The CBB implemented measures to properly channel FX flows within the banking system. Moreover, the authorities have met with the major U.S. bank that terminated CBRs to understand the reason for termination. They have also met with U.S. officials for similar purpose and in attempt to secure replacement CBRs.

40. **The loss of CBRs has exacerbated the structural weaknesses in the foreign exchange market, and hampered the smooth processing of the increased volume of international transactions in banks that have CBRs.** Traditionally, most of the foreign exchange is generated by the largest bank through banking services to businesses in the productive sectors. This bank is the one most affected by the loss of CBRs.

41. **Deposits in the offshore banking system have continued to fall, driven by a continued strong decrease in international banks' deposits (Figures 5-6) and an increase in domestic bank deposits.** Total deposits in the banking fell by 0.5 percent (y/y) on average during 2016Q2–2016Q4, following a decline of 5.3 percent (y/y) during 2015Q2–2015Q4. At the same time, international banks' deposit declined by an average of 16.6 percent (y/y) compared to an average declined of 27 percent. Meanwhile, domestic banks deposit grew by 5.3 percent compared to 6.2 percent (y/y) in the corresponding period.

42. **The slowdown in deposits appears to have affected aggregate credit growth.** Banking system total loans increased by 1.8 percent (y/y) on average during 2016Q2–2016Q4 compared to an increase of 3.4 percent (y/y) on average during 2015Q2–2015Q4.

E. Policy Recommendations

Toward a Stronger Financial System

43. **Efforts to further strengthen banks' balance sheets should continue, especially considering the recent deterioration of the asset quality of the state-owned bank.** In the context of the still high NPLs and low capital buffers in some banks, the authorities should order the recapitalization of some banks by their owners, including through sales of seized collateral. For banks that were granted an extension on provisioning requirements, current restrictions (prohibition to distribute profits and greater scrutiny on payment of management fees and lending) should remain until the authorities are fully confident that these banks are in a sound financial position.

44. **An assessment of the true strength of banks' balance sheets through asset quality reviews (AQRs) remains a priority.** The AQR would provide a thorough review of banks' portfolios, complementing reviews by the Central Bank's examiners. In the meantime, the authorities should

raise provisioning requirements gradually to 100 percent for all loan losses (secured and unsecured), allowing a reasonable transition period during which dividend distribution is strictly forbidden and management fees contained.

45. **The authorities should address weaknesses in the framework for NPL resolution.** Given banks' reliance on a private credit bureau with voluntary participation, expediting the establishment of a formal credit bureau is a priority. In addition, setting up public registers for movable property and for real estate transactions would increase the information set for collateral valuation and therefore facilitate NPL resolution. Strengthening the insolvency regime is also important for resolving bad debts.

46. **Initiatives to enhance financial stability analysis and reporting should continue.** More resources should be allocated to the Financial Stability Unit to ensure a timely completion of Financial Stability Reports, including macro-prudential indicators and measures of systemic risk that were developed with CARTAC technical assistance.

47. **A more developed capital market with appropriate safeguards would help strengthen banks' balance sheets more rapidly.** Safeguards must ensure transparency and disclosures, including on beneficial ownership, and guarantee that any investor who acquires a significant stake in financial institutions fully meet tests of fitness and propriety. Such capital markets could potentially allow banks to tap into the current liquidity to raise capital and promptly bring provisioning to the required prudential levels or else dispose of non-performing assets, including through asset management companies.

Toward addressing CBR challenges

48. **Coordinated and collective actions by the public and private sectors stakeholders are needed.** In addition to efforts to enhance the understanding of the phenomenon, several initiatives including to address the specific drivers and mitigate the potential impact of CBR withdrawal are being considered, and some already being implemented. Recognizing that the macroeconomic impact of CBR withdrawal has been limited so far, the focus of most of these initiatives has been on preventing CBR withdrawal from reaching a critical level.

49. **In Belize, where the withdrawal of CBR has been significant, there is need for alternative arrangements and market solutions to mitigate the potential impact of CBR withdrawal.** Belizean banks have tried to replace lost CBRs with smaller, less known specialized financial institutions, with most of the new CBRs provided by one respondent bank. Other options that could be explored include switching to CBRs in other currencies, and relying on other type of cross-border financial services, such as letter of credit and trade finance. However, these options do not address the underlying drivers of the CBR losses.

50. **Enhancing Belizean banks' capacity to manage risks is an immediate priority.** Enhanced communication between correspondent banks and Belizean banks would foster a common understanding of risks, and clarify global banks' risks tolerance policies, or their reason(s) for terminating CBRs. Correspondent banks could usefully issue policy statements on transactions that

are considered high risk, and provide technical support to Belizean banks where necessary to strengthen risk management. Belizean banks are encouraged to take advantage of a planned capacity building program by the Caribbean Development Bank (CDB) to address increasing requirements for customer due diligence and transaction monitoring.

51. Special protocols for high-risk, legitimate activity could be developed. Terminating relationships with clients in high-risk sectors where capacity to manage such risk is lacking may reduce overall risk level of CBRs and allay concerns of correspondent banks. However, such actions may exclude legitimate but risky business and hamper financial inclusion. Remittances, for example, are generally considered to be a high-risk activity, but have an overall positive social and economic impact. In this context, Belizean banks could develop special protocols, in consultation with their correspondent banks for customer due diligence with respect to higher-risk but legitimate activities. Moreover, they should also consider consolidating transactional traffic by bundling correspondent banking services with other products, such as wealth management, credit card clearing, and letter of credit.

52. Further strengthening of the risk-based AML/CFT supervision of domestic and offshore banks could help reduce risks. In this context, the ongoing National Risk Assessment by the FIU that will identify the ML/CF risks to which Belize is exposed is critical. Stronger AML/CFT regulation and supervision should center around a forward-looking risk-based assessment. The CBB should continue enhancing the risk-based supervision, stepping-up inspections of banks and impose corrective actions and sanctions when relevant.

53. Reassessing the sustainability of the business model combined with a stronger regulation and supervision of the non-bank offshore sector is also crucial. Recent efforts to ensure proper licensing and monitoring of registered agents and service providers for compliance with the AML/CFT requirements on a risk basis, particularly relating to the availability of beneficial ownership information of legal persons and arrangements they are involved in creating, should continue. The IFSC should also require licensed financial services to have premises in Belize and initiate their supervision. To the extent Belizean Banks lack the capacity to manage risks associated with certain high-risk businesses related to the offshore center, they may need to terminate such business applying a risk-based approach, so as to maintain their CBRs.

54. Investment in effective mechanisms to ensure entity transparency and better understanding of related ML/TF risks would improve compliance with international standards. In addition, the authorities should expedite the amendment of necessary legislation and effectively implement them to allow timely access to adequate, accurate, and current information on beneficial ownership of all types of entities created in Belize.

55. Stricter licensing and robust prudential requirements together with enhanced transparency and mitigation and reduction of the ML/TF risks would help address the loss of CBRs. Higher licensing and capital requirements and fees for company registration combined with stricter obligations for financial service providers to hold offices in Belize and have proper ML/TF internal controls would help mitigating the risks related to the offshore sector and increase the revenue of the IFSC, which would enhance its independence and capacity. The authorities should consider introducing taxation for registered entities.

56. Solid contingency plans, including using the CBB to channel funds, could be considered in addressing the loss of CBRs to maintain competition in the processing of international transactions. This would keep the cost of cross-border financial services at affordable levels, preserve competition and prevent such transactions from moving to less transparent channels. The central bank's CBRs could be used as an emergency, time bound measure, as was done recently. But the central bank must be equipped to perform the necessary due diligence and manage the associated high frequency of cross-border transactions.

57. Technological innovations, aimed at reducing cost and managing risk, could be considered. Emerging technology solutions (blockchain and Fintech) could provide a more efficient alternative to CBRs for carrying out cross-border transactions. However, these largely untested technologies, which are being explored by correspondent banks, look like a longer-term solution. These new technologies still need to be brought under the regulatory and supervisory perimeter of the authorities.

F. Concluding Remarks

58. Belize has made commendable progress in strengthening the financial system. NPLs ratios continue to slowly decline. Provisioning and reported capital buffers are also improving. Important projects that would strengthen the financial system infrastructure have advanced, with a launch of an automated payment system last year. A ML/TF national risk assessment is ongoing. Nonetheless, weaknesses in the banking system have not gone away. NPLs ratio need to be further reduced; and provisioning further improved as illustrated by forbearance on provisioning rules for some banks. The comfortable levels of the banking system's reported capital adequacy ratios mask low or inflated capital buffers in some banks. Withdrawal of CBRs remains a key vulnerability.

59. Efforts to address remaining vulnerabilities should continue in multiple fronts. The true strength of banks' capital buffers should be assessed through an asset quality review (AQR). Weak banks should be ordered to raise more capital, while maintaining restrictions on lending and distribution of dividend. Well-developed capital markets would help banks strengthen balance sheets more rapidly. Such capital markets could potentially allow banks to tap into the current liquidity to raise capital and promptly bring provisioning to the required prudential levels, or else dispose of non-performing assets. The framework for resolving distress assets should be put in place, including a credit bureau. There is need for more alternative arrangements and market solutions to mitigate the impact of CBR withdrawal. The authorities should continue to monitor CBRs and avoid further losses by strengthening the effectiveness of the AML/CFT framework, including by properly supervising licensed entities and enhancing transparency in the offshore sector.

Table 1. Belize: Structure of the Financial System

	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	Mar-17
Number of institutions												
Domestic commercial banks	5	5	5	5	5	5	5	6	6	6	5	5
International commercial banks	8	8	7	7	8	7	7	6	6	5	5	5
Credit unions	14	13	14	14	13	12	12	12	12	12	12	8
Nonbank financial institutions (incl. the DFC)	1	1	1	3	3	2	2	2	1	1	1	1
Domestic insurance companies	15	14	14	13	14	12	12	14	12	9	9	9
<i>Of which: Inactive</i>	2	1	...	...	...	...	...	...	...	...	...	...
Financial system assets (BZ\$ millions)	3,059	3,424	3,747	4,108	4,360	4,674	5,031	5,204	5,674	5,642	5,569	5,705
Domestic commercial banks	1,883	2,121	2,419	2,512	2,498	2,552	2,760	2,830	2,997	3,249	3,228	3,268
International commercial banks	618	716	684	783	975	1,178	1,308	1,339	1,573	1,204	1,061	1,135
Credit unions 1/	351	391	443	483	535	589	651	717	765.4	831.3	903.5	920.8
Nonbank financial institutions (incl. the DFC)	31	31	33	151	159	144	97	92	90	104	105	105
Domestic insurance companies	176	166	168	179	193	211	216	226	248	253	272	277
	207	197	201	330	352	355	313	318	338	357	377	382
Assets as percent of total financial system												
Domestic commercial banks	61.6	61.9	64.6	61.2	57.3	54.6	54.9	54.4	52.8	57.6	58.0	57.3
International commercial banks	20.2	20.9	18.2	19.1	22.4	25.2	26.0	25.7	27.7	21.3	19.1	19.9
Credit unions 1/	11.5	11.4	11.8	11.7	12.3	12.6	12.9	13.8	13.5	14.7	16.2	16.1
Nonbank financial institutions (incl. the DFC)	1.0	0.9	0.9	3.7	3.6	3.1	1.9	1.8	1.6	1.8	1.9	1.8
Domestic insurance companies	5.8	4.8	4.5	4.4	4.4	4.5	4.3	4.3	4.4	4.5	4.9	4.9
Assets as percent of GDP	125.6	132.7	136.8	153.4	155.9	157.2	159.9	161.2	166.2	161.9	160.0	156.8
Domestic commercial banks	77.3	82.2	88.3	93.8	89.3	85.8	87.7	87.7	87.8	93.2	92.7	89.8
International commercial banks	25.4	27.7	25.0	29.2	34.9	39.6	41.5	41.5	46.1	34.6	30.5	31.2
Credit unions 1/	14.4	15.1	16.2	18.0	19.1	19.8	20.7	22.2	22.4	23.9	26.0	25.3
Nonbank financial institutions (incl. the DFC)	1.3	1.2	1.2	5.6	5.7	4.8	3.1	2.9	2.6	3.0	3.0	2.9
Domestic insurance companies	7.2	6.4	6.1	6.7	6.9	7.1	6.9	7.0	7.3	7.3	7.8	7.6
Memorandum item:												
Nominal GDP (BZ\$ million)	2,435	2,581	2,739	2,677	2,797	2,973	3,147	3,227	3,413	3,485	3,481	3,638

Source: Central Bank of Belize.

1/ Data from the seven largest credit unions.

Table 2. Belize: Financial Soundness Indicators of the Banking System (Commercial Banks)
(In percent, unless indicated otherwise)

	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	Mar-17
Capital adequacy												
Regulatory capital to risk-weighted assets	21.2	23.1	19.5	20.7	22.4	23.7	22.3	24.4	23.7	19.4	23.5	24.9
Regulatory capital to total assets	16.4	17.2	14.4	15.2	15.3	14.1	13.1	13.7	13.1	13.8	13.6	13.6
Sectoral distribution of loans to total loans												
Households	23.2	23.5	21.9	20.7	21.8	23.1	23.6	23.7	22.9	22.9	21.6	21.1
Agriculture	7.7	7.6	7.8	7.4	7.5	7.6	6.9	8.2	10.4	10.2	10.1	11.9
Building and construction	22.8	22.8	23.6	26.4	25.4	25.3	26.5	27.3	27.2	29.1	28.5	27.7
Manufacturing	1.8	2.0	2.4	2.7	2.7	2.0	1.8	1.3	1.1	1.8	1.9	2.1
Tourism	5.7	8.9	7.6	7.2	7.8	6.2	5.3	5.0	5.0	4.8	6.5	6.0
Real estate	11.7	9.6	10.6	10.9	10.8	12.1	13.3	14.3	14.4	14.8	14.6	14.6
Retail and wholesale	12.5	11.6	13.1	12.3	12.4	12.1	11.2	9.8	9.5	8.6	7.9	8.4
Transport	3.3	3.5	4.4	4.2	3.3	2.9	2.8	2.1	2.3	2.4	2.7	2.7
Others	11.5	10.6	8.6	8.1	8.2	8.7	8.5	8.2	7.3	5.4	6.3	5.4
Banking sector asset quality												
Nonperforming loans to gross loans	6.2	6.6	12.7	12.2	18.4	19.0	17.2	14.8	14.3	14.0	10.4	7.7
Provisions to nonperforming loans	34.5	34.2	23.1	19.5	18.2	28.0	40.8	46.0	57.8	61.9	79.8	81.7
NPLs net of specific provisions to capital	22.3	23.3	53.4	50.9	74.2	70.7	55.2	42.3	34.6	29.7	13.8	10.5
Specific provisions to gross lending	1.3	1.2	2.0	1.4	2.3	4.5	6.2	5.9	7.3	7.3	7.4	5.4
Banking sector earnings and profitability												
Return on average equity (before taxes)	23.2	22.4	0.1	2.9	2.3	0.7	-4.6	0.2	-7.8	-10.1	6.8	7.6
Return on average assets (before taxes)	3.7	3.7	0.6	1.3	1.2	1.0	0.5	1.1	1.3	-0.5	1.9	2.0
Return on average assets (after taxes)	3.7	3.7	0.0	0.4	0.3	0.1	-0.6	0.0	-1.1	-1.4	0.9	1.0
Interest margin to gross income	45.9	47.1	36.1	40.4	45.6	49.3	54.5	57.6	59.8	56.7	60.4	57.6
Non-interest expenses to gross income	38.5	37.6	42.8	35.4	38.9	43.2	46.5	51.4	47.2	63.1	55.3	53.2
Spread between average lending and deposit rates	8.5	8.3	7.8	7.9	8.2	9.4	9.4	9.0	8.5	8.6	8.4	8.3
Banking sector liquidity												
Liquid assets to total assets	19.9	19.7	20.3	21.9	24.3	27.2	29.6	28.8	30.1	32.2	32.8	32.4
Liquid assets to total short-term liabilities	25.4	25.6	25.7	27.4	30.5	33.4	37.0	35.5	36.3	40.0	39.4	39.4
Total deposits to total loans	99.8	100.1	104.5	108.3	111.4	117.5	127.0	124.3	128.1	132.4	132.5	136.2
Foreign currency liabilities to total liabilities	8.0	3.8	6.8	3.5	2.1	0.9	0.3	1.1	1.4	1.2	0.5	0.7
Banking sector sensitivity to market risk												
Net open positions in FX to capital	19.3	27.7	11.5	16.3	30.2	...	...	68.7	63.5	32.3	...	...

Sources: Central Bank of Belize; and Fund staff calculations.

Table 3. Capital Requirements of Operators Licensed by the IFSC
(Amount in USD deposited in offshore banks in Belize)

Type of licences	Number of Licences		Capital Requirement ('000)		Amounted Deposited ('000)	
	2016	2017	2016	2017	2016	2017 1/
Registered Agents	98	86	5	10	490	860
Trust Service	50	45	10	15	500	675
Mutual Funds (Public)	0	1	50	50	0	50
Mutual Funds (Private)	2	2	30	30	60	60
Asset Protection	17	11	25	25	425	275
Trading in Securities	97	89	100	500	9,700	44,500
Trading in Foreign Exchange	7	7	100	500	700	3,500
Money Lending Services	1	1	50	75	50	75
Brokerage Consultancy	15	13	25	50	375	650
Safe Custody	1	0	25	50	25	0
Money Transmission	5	4	50	75	250	300
Money Broker	0	0	25	75	0	0
Money Exchange	2	1	75	75	150	75
Payment System	5	5	50	75	250	375
Accounting Services	0	0	25	25	0	0
Total	300	265	...	...	12,975	51,395

Source: Belize International Financial Services Commission

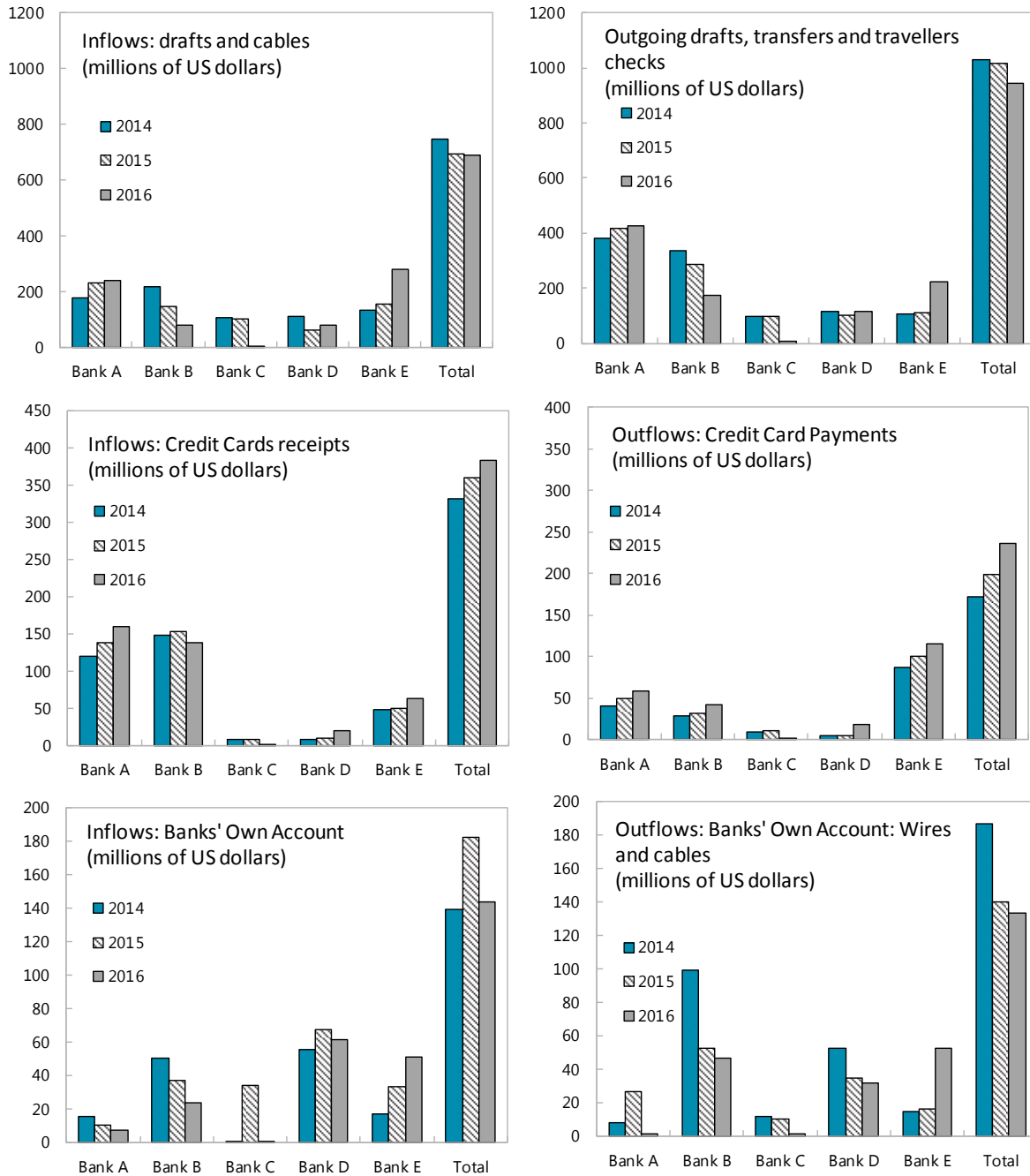
1/ As of May 2017

Table 4. Number of Legal Persons and Arrangement Registered in the Offshore Sector
(Legal person-Companies and Foundations)

	2015	2016	Jan-May 2017
Companies-International Business Corporations			
Incorporation	7,747	5,970	2,276
Total	63,478	55,867	47,623
Companies-Limited Liability Companies			
Incorporation	80	64	21
Total	272	316	324
Foundations			
Registered	47	23	13
Total	197	220	233
Legal Arrangements-Trusts	152	129	63
Total	1,829	1,712	1,766

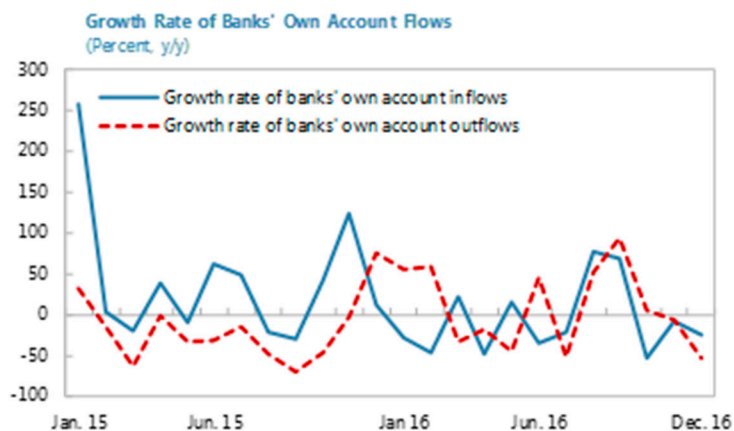
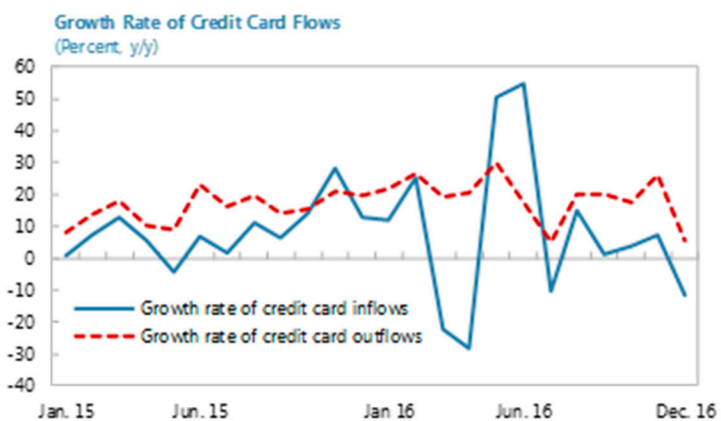
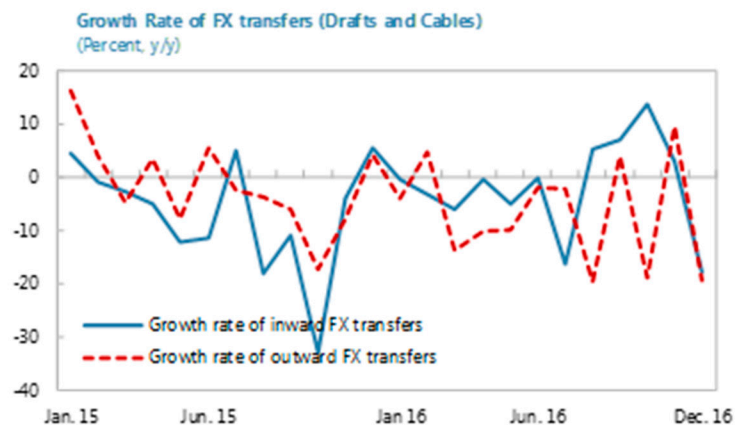
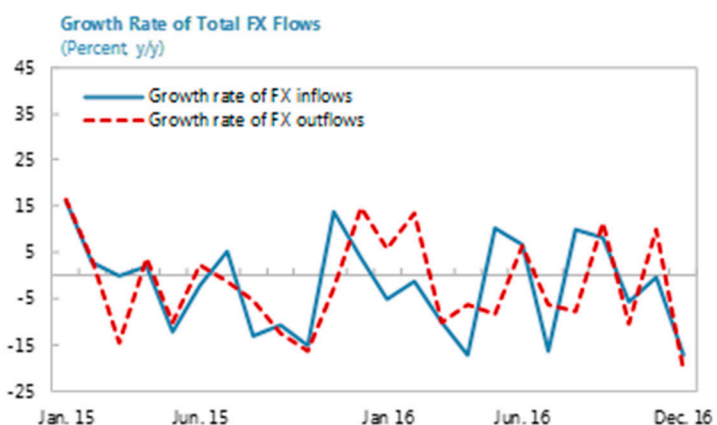
Source: Belize International Financial Services Commission

Figure 1. Belize: Evidence from FX Market Data, 2014-16



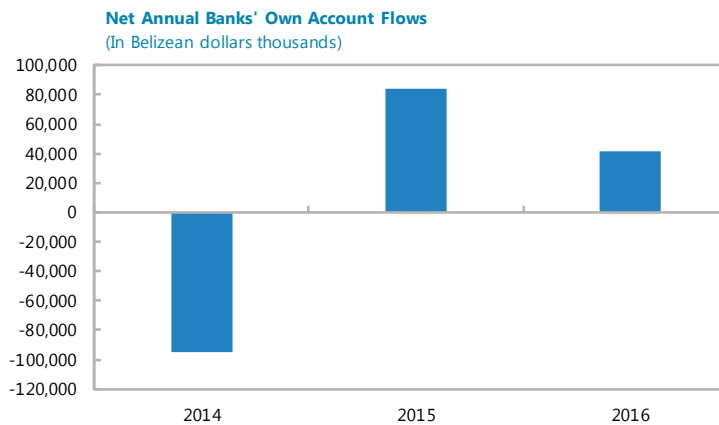
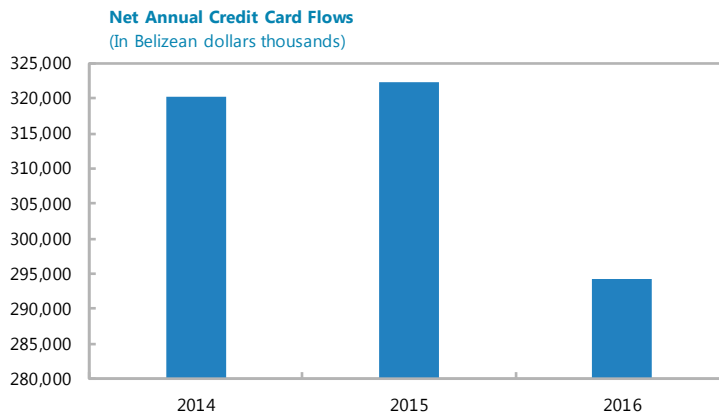
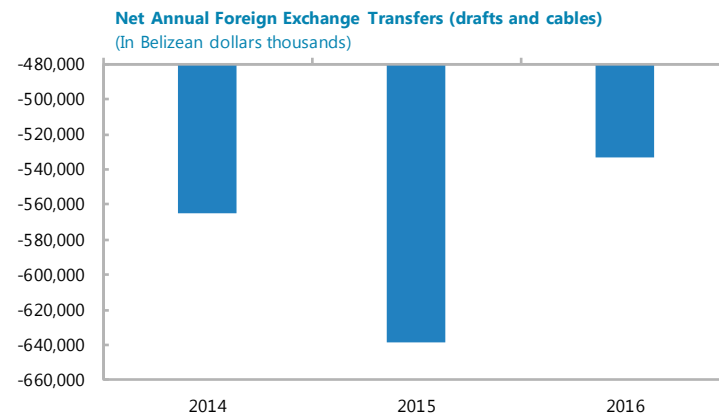
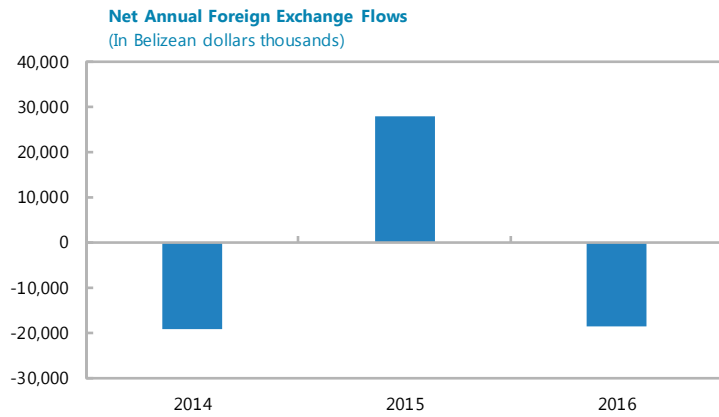
Source: Central Bank of Belize; IMF Staff calculations

Figure 2. Belize: Growth Rates of Foreign Exchange Flows by Instrument



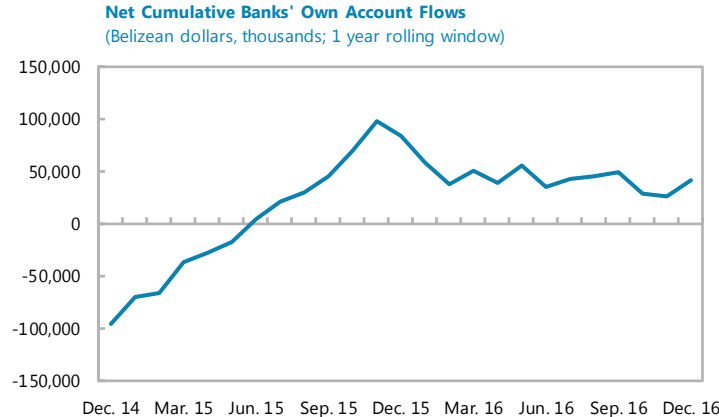
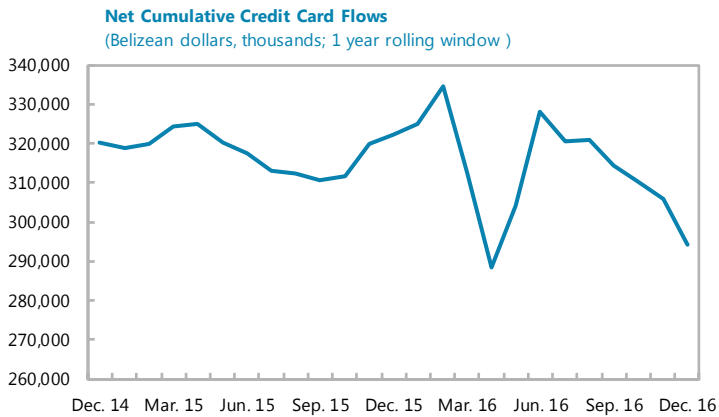
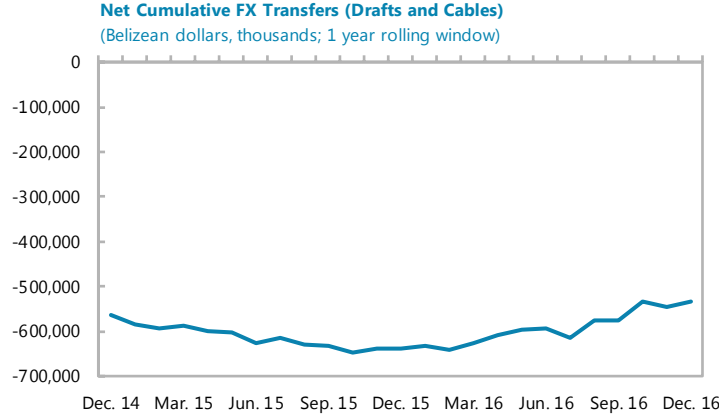
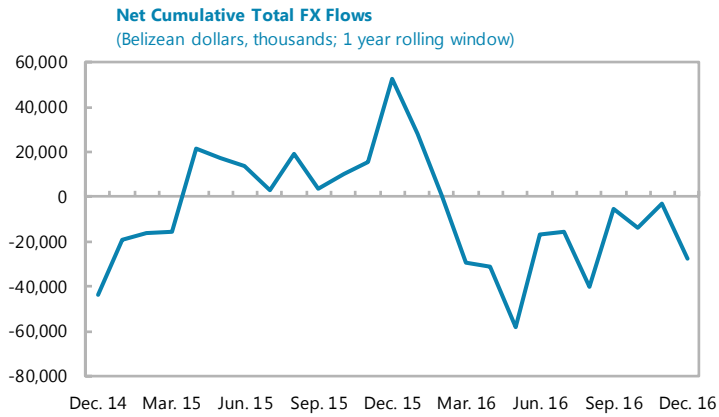
Source: Central Bank of Belize and Fund staff calculations.

Figure 3. Belize: Annual Net Foreign Exchange Flows by Instrument



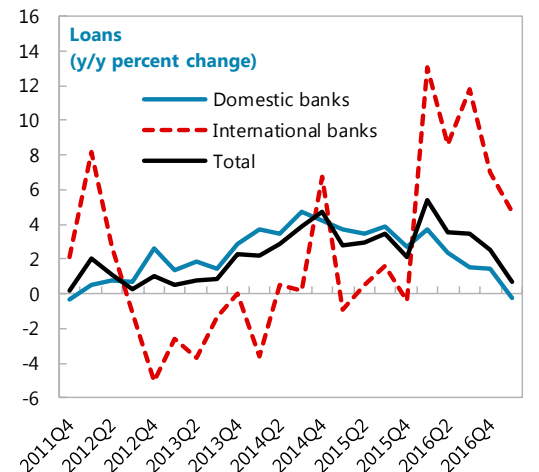
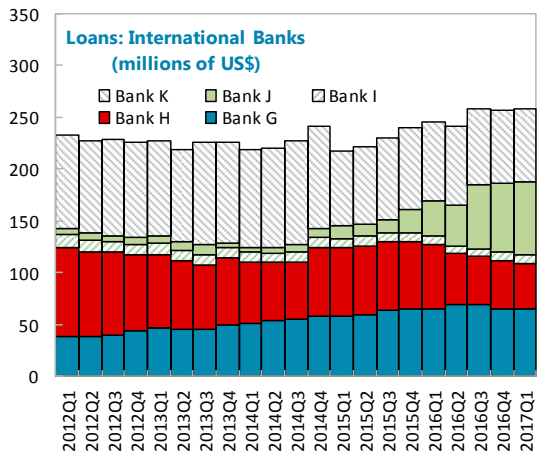
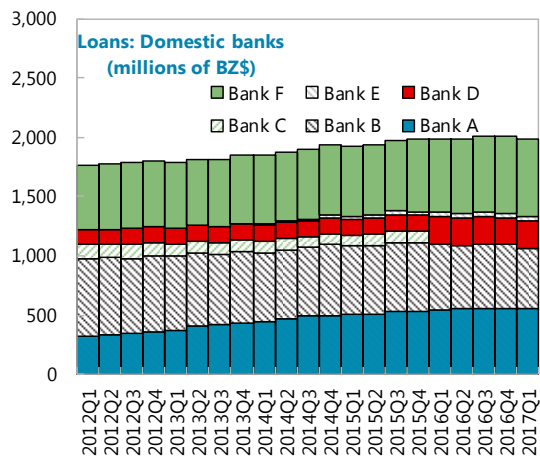
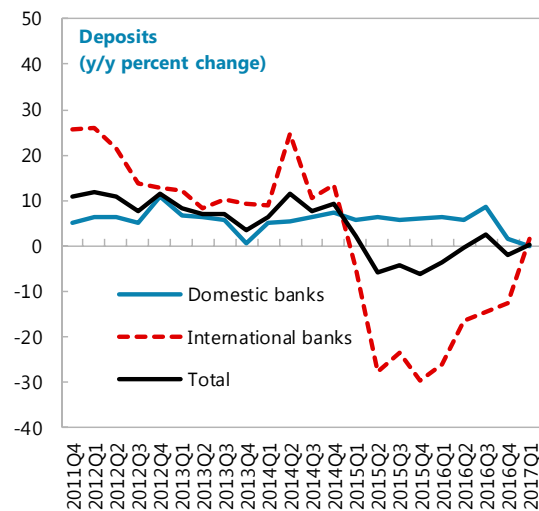
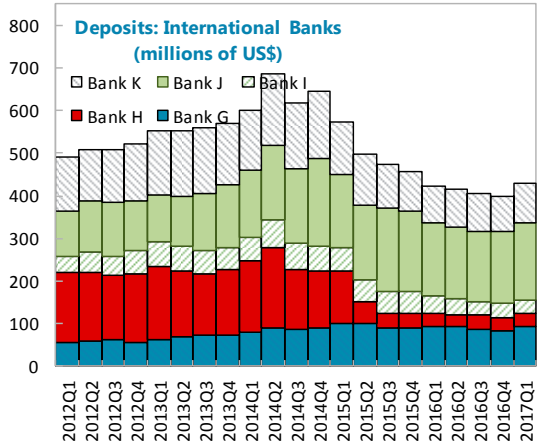
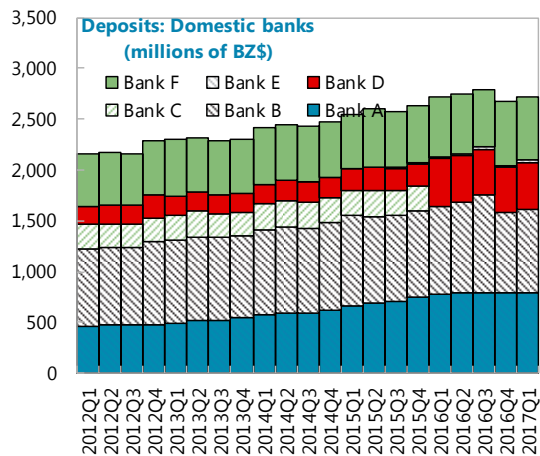
Source: Central Bank of Belize and Fund staff calculations.

Figure 4. Belize: Net Cumulative Foreign Flows by Instrument



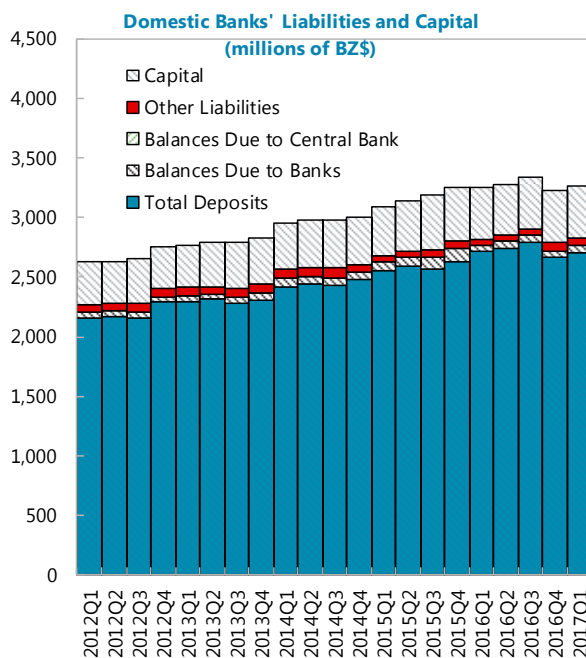
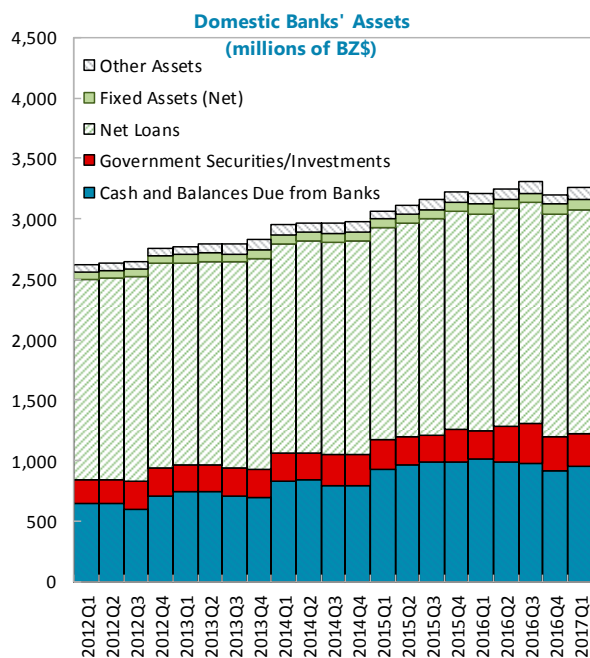
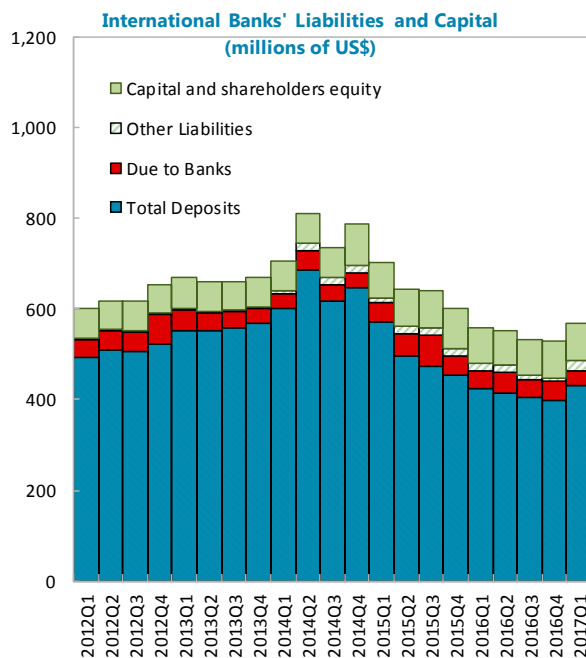
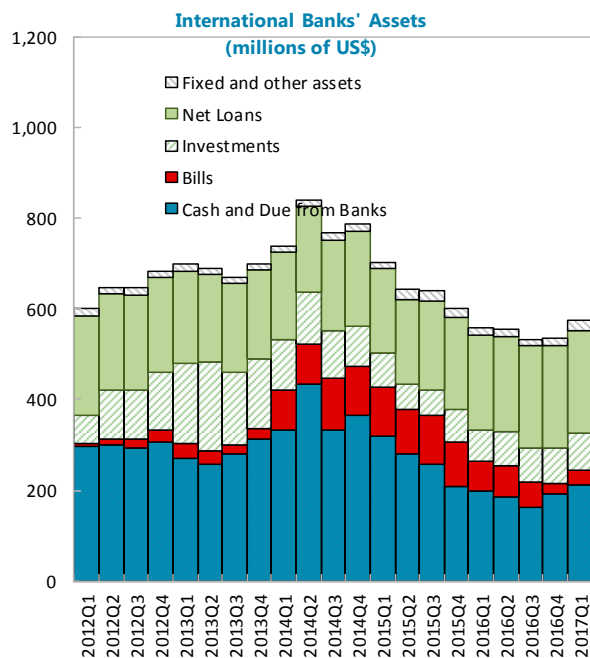
Source: Central Bank of Belize and Fund staff calculations.

Figure 5. Belize: Domestic and International Banks' Deposits and Loans, Dec. 2012-Mar. 2017



Source: Central Bank of Belize and Fund staff estimations.

Figure 6. Belize: Bank Balance Sheets, Dec. 2012-Mar. 2017



Source: Central Bank of Belize and Fund staff estimations.

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