FINANCIAL STABILITY REPORT

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Financial Services Authority Seychelles

SEYCHELLES FIU

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Letter of Transmittal

Central Bank of Seychelles

P.O. Box 701

Victoria

June 28, 2024

President Wavel Ramkalawan

State House

Victoria

Dear Mr President,

On behalf of the Financial Stability Committee, I have the honour to submit the First Financial Stability Report for the year ended December 31, 2023, in accordance with Section 11 (1) of the Financial Stability Act, 2023.

Yours sincerely,

C. Abel (Ms)

Chairperson of Financial Stability Committee and

Governor of Central Bank of Seychelles

Acronyms

AML/CFT	Anti-Money Laundering and Countering the Financing of Terrorism
BCBS	Basel Committee on Banking Supervision
BCP	Basel Core Principles
CBS	Central Bank of Seychelles
EOIR	Exchange of Information on Request
ERM	Enterprise Risk Management
EU	European Union
FATF	Financial Action Task Force
FIU	Financial Intelligence Unit
FMI	Financial Market Infrastructure
FSA	Financial Services Authority
FSB	Financial Stability Board
FSC	Financial Stability Committee
IADI	International Association of Deposit Insurers
IAGR	International Association of Gaming Regulators
IAIS	International Association of Insurance Supervisors
IBC	International Business Companies
ICP	Insurance Core Principles
IEC	International Electrotechnical Commission
IFRS	International Financial Reporting Standards
IOSCO	International Organisation of Securities Commissions
ISO	International Organisation for Standardisation
ISSB	International Sustainability Standards Board
IT	Information Technology

KYC	Know Your Customer
ML/TF	Money Laundering and Terrorism Financing
NGFS	Network for Greening the Financial System
NPLs	Non-Performing Loans
OECD	Organisation for Economic Co-operation and Development
VA	Virtual Asset
VASP	Virtual Asset Service Provider

International Organisations, Standards and Codes

BASEL COMMITTEE ON BANKING SUPERVISION (BCBS)	The Basel Committee on Banking Supervision (BCBS) is an international standard-setting body that develops global standards and guidelines for banking supervision. It aims to enhance the stability and integrity of the international banking system by promoting effective banking supervision, risk management practices, and regulatory compliance across jurisdictions.
BASEL CORE PRINCIPLES (BCP)	The Basel Core Principles (BCP) are a set of internationally recognised standards established by the BCBS to assess the effectiveness of banking supervision frameworks worldwide. These principles cover key areas such as regulatory and supervisory powers, risk management, and transparency, aiming to promote the soundness and stability of the global banking system.
FINANCIAL ACTION TASK FORCE (FATF)	The Financial Action Task Force (FATF) is an intergovernmental organisation with the aim of combating money laundering, terrorist financing, and other threats towards the integrity of the international financial system. FATF develops and promotes policies and standards to combat these illicit activities, and it conducts mutual assessments of member countries' compliance with these standards, which allow for effectiveness and adherence to international standards.
FINANCIAL STABILITY BOARD (FSB)	The Financial Stability Board (FSB) is an international body that coordinates the regulation and supervision of the global financial system. It works to promote financial stability by assessing vulnerabilities in the financial system, identifying and addressing systemic risks, and developing international standards and policies for financial regulation and supervision.
INTERNATIONAL ASSOCIATION OF DEPOSIT INSURERS (IADI)	The International Association of Deposit Insurers (IADI) is a global organisation that promotes the stability of financial systems by facilitating cooperation among deposit insurance agencies worldwide. It sets international standards for the effective operation of deposit insurance systems, encourages the exchange of information and best practices among members, and

	provides technical assistance to enhance the resilience of deposit insurance schemes.
INTERNATIONAL ASSOCIATION OF GAMING REGULATORS (IAGR)	The International Association of Gaming Regulators (IAGR) is an organisation of gaming and gambling regulators working towards promoting effective and efficient gaming regulations. It also provides a forum for exchanging best practices, sharing information and discussing legislation, policies and procedures.
INTERNATIONAL ASSOCIATION OF INSURANCE SUPERVISORS (IAIS)	The International Association of Insurance Supervisors (IAIS) is the global standard-setting body for the insurance industry. It aims to promote effective and globally consistent supervision of the insurance industry. It develops and implements principles, standards, and guidance for insurance supervision, with the objective of enhancing financial stability and consumer protection worldwide.
INSURANCE CORE PRINCIPLES (ICP)	Insurance Core Principles (ICP) are globally recognised standards and guidelines established by the IAIS. The set of established principles provides the framework for the supervision and regulation of the insurance industry worldwide. It aims to cover various aspects of insurance operations, including risk management, solvency assessment, corporate governance, market conduct, and consumer protection.
INTERNATIONAL ELECTROTECHNICAL COMMISSION (IEC)	International Electrotechnical Commission (IEC) is an international standards organisation that prepares and publishes international standards for all electrical, electronic and related technologies known collectively as “electrotechnical”. The organisation also uses conformity assessments to ensure the standards are applied appropriately.
INTERNATIONAL ORGANISATION OF SECURITIES COMMISSIONS (IOSCO)	The International Organisation of Securities Commissions (IOSCO) is the global association of securities regulators. It aims to develop, implement, and promote standards for securities regulation and assist the member countries to engage and co-operate to enhance the efficiency, transparency, and integrity of securities markets worldwide. Furthermore, it facilitates cross-border collaboration and information exchange amongst the

	regulators to address emerging issues and promote investor protection.
INTERNATIONAL ORGANISATION FOR STANDARDISATION (ISO)	International Organisation of Standards (ISO) is an international organisation that develop standards to ensure quality, safety and efficiency of services, products and systems. The standards cover a wide range of industries and sectors with the aim of providing a common reference and framework for organisations globally.
INTERNATIONAL SUSTAINABILITY STANDARDS BOARD (ISSB)	International Sustainability Standards Board (ISSB) is an international standard-setting body mandated with the development of sustainability-related financial reporting standards, which will serve as a global framework for sustainability disclosures. The body operates under the oversight of the International Financial Reporting Standard (IFRS) Foundation.
NETWORK FOR GREENING THE FINANCIAL SYSTEM (NGFS)	Network for Greening the Financial System (NGFS) is comprised of central banks and supervisors working to enhance the financial sectors' response to climate change. It provides guidance, research and best practices for integrating climate-related risks into financial supervision and regulation.
ORGANISATION FOR ECONOMIC CO-OPERATION AND DEVELOPMENT (OECD)	The Organisation for Economic Co-operation and Development (OECD) is an international organisation comprising 38 member countries. It aims to promote policies to improve economic growth and social stability through data analysis, research, and policy recommendations whilst maintaining a principle of sustainability and inclusiveness. It further encourages co-operation and exchange of best practices amongst member countries.

1 Executive Summary

Financial stability has risen in prominence globally in recent years, becoming an important policy objective alongside price stability and fiscal sustainability. The importance of financial stability emanates from the fact that it is an important pre-condition to sustainable economic growth.

Recognising the importance of financial stability for the country, the Financial Stability Committee (FSC) was established in 2016, by order of the President of the Republic. The FSC is chaired by the Governor of the Central Bank of Seychelles (CBS) and includes members from CBS, the Ministry responsible for Finance, the Financial Services Authority (FSA), and the Financial Intelligence Unit (FIU). Its primary role is to uphold domestic financial stability.

The enactment of the Financial Stability Act, 2023, in December 2023, was a significant milestone, providing the FSC with the legal basis and necessary institutional structure to execute its duties and strengthen financial stability governance. The legislation has provided the FSC with a clear mandate for financial stability oversight in Seychelles and has underlined the functions and powers of the Committee. Moreover, in terms of accountability, the Financial Stability Act requires that the FSC submits a report on financial stability to the President and the National Assembly, not later than six months after the end of each financial year. This will further elevate financial stability as an issue of national importance.

As the global economic and financial landscape continue to evolve, the country's financial system is exposed to various financial and non-financial risks, which impact on its ability to effectively perform its primary role of financial intermediation. To note, risks to financial stability continue to evolve and originate from sources beyond the fields of economics and finance, such as cybersecurity and climate-related risks, which pose significant threats if not managed effectively. Given the interconnected nature of the financial system, these risks can have cascading effects on both banking and non-banking sectors, making a robust financial stability framework essential for identifying and mitigating risks.

Strengthening the domestic financial stability framework thus remains a priority for the FSC and the enactment of the Financial Stability Act, 2023, is evidence of progress in that regard. Looking ahead, the FSC is committed to developing a comprehensive Financial Stability Strategic Plan for Seychelles, aimed at addressing deficiencies in the domestic financial system and strengthening the country's resilience to systemic shocks.

Against this backdrop, the FSC presents its Financial Stability Report for 2023. This edition, focuses on providing an overview of the domestic financial stability framework and the systemic risks faced by the country's financial system. To note, this is the first report published under the Financial Stability Act, 2023, and is jointly prepared by the member institutions of the FSC.

This edition of the Financial Stability Report is for educational purposes to promote awareness on the concept of financial stability and its implication for the country.

2 Why Financial Stability

The financial system is comprised of financial institutions and markets - like banks, insurance companies, securities, foreign exchange and money markets. It also includes market infrastructures like payments and settlement systems. The financial system plays a key role in financial intermediation by channelling funds from savers to borrowers, which helps promote economic growth. Therefore, a stable financial system is vital to the macroeconomic stability of a country.

In the Seychelles context, financial stability is defined as a condition whereby the financial system is able to adequately perform its financial intermediation role, whilst managing systemic risks[1] effectively and remaining resilient to systemic shocks, to attain sustainable development and inclusive economic growth. Therefore, when financial stability prevails, risks and vulnerabilities are effectively mitigated, whereby adverse systemic events and loss of public confidence in the financial system are less likely to occur.

Risks to financial stability emanate from multiple sources and are continuously evolving over time, prompting instability in the financial system. Financial instability may arise from both domestic sources and external shocks, such as the failure of a domestically systemic financial institution or from a global financial crisis. Both types of events cause financial instability and erode public confidence in the financial system and economy as a whole.

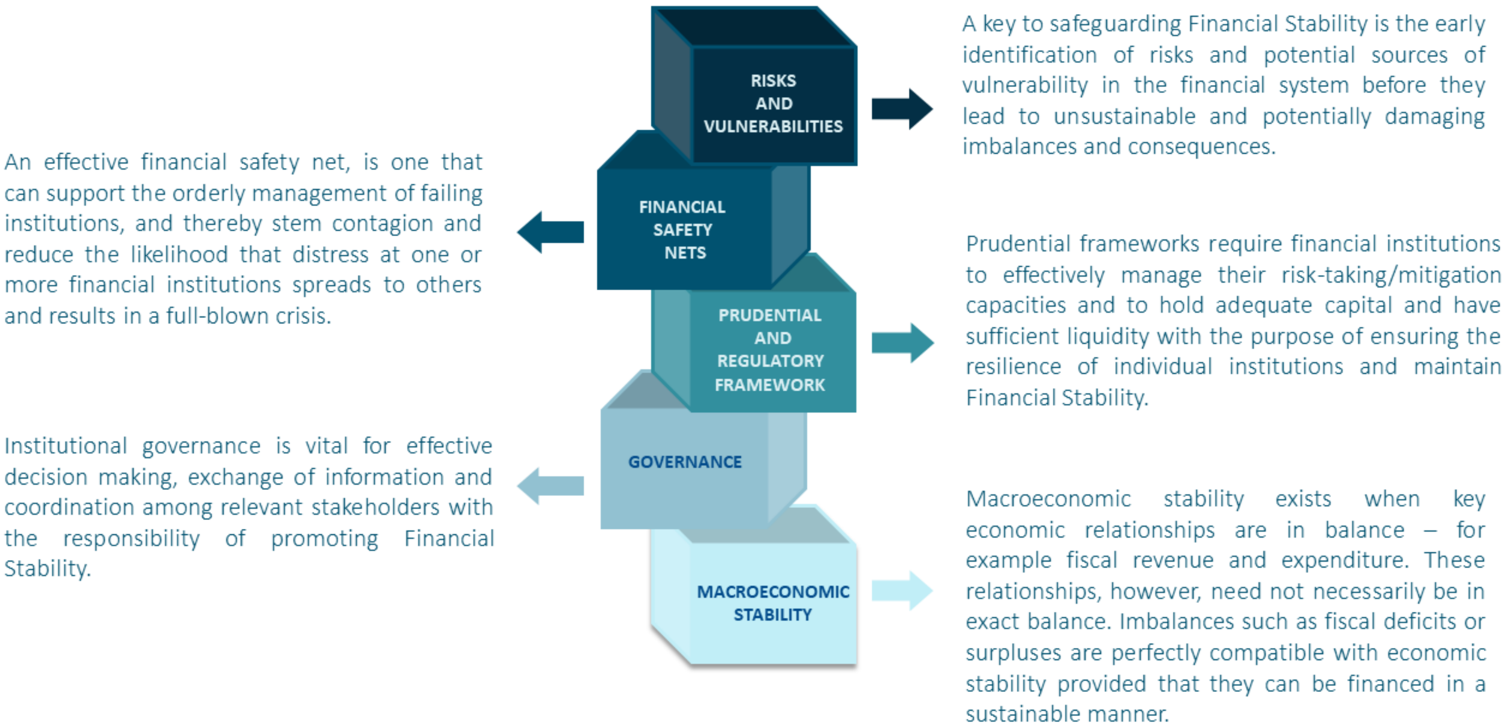
Given the ever changing macroeconomic and financial landscape, there is a need to constantly monitor financial markets and economic developments, which is necessary for timely actions guided by informed and sound policy decisions. Ensuring that all stakeholders including the general public remain well-informed, is also vital to enhance awareness and encourage collective responsibility, ultimately promoting financial stability.

[1] Systemic risks are defined as risks of disruptions to the provision of financial services that is caused by an impairment of all or parts of the financial system, and can cause serious negative consequences for the real economy.

3 State of Play

The importance of maintaining financial stability and ensuring the resilience of the financial system to systemic shocks have globally been recognised. On the domestic front, work continues to develop a financial stability framework which is aligned with international best practices and standards by addressing key deficiencies identified in a structured approach. There are broadly five essential building blocks to achieving financial stability. These building blocks, illustrated in Figure 1 below are; macroeconomic stability (pre-condition), governance, sound prudential and regulatory frameworks, financial safety nets and risk and vulnerabilities. The status of each of these building blocks is provided in this section.

Figure 1: Financial Stability building blocks



3.1 Macroeconomic Stability

Macroeconomic stability and financial stability are interdependent. A stable macroeconomic environment supports financial stability, while a sound financial system contributes to overall macroeconomic stability.

A stable macroeconomic environment provides a solid foundation for financial stability. For instance, low and stable inflation foster confidence in the domestic currency and financial markets, encouraging investment and lending activities. Similarly, sustained economic growth and low unemployment contribute to stable incomes and repayment capacity, reducing the likelihood of default on loans and other financial obligations.

Conversely, financial stability is essential for maintaining the macroeconomic stability of a country. A well-functioning financial system facilitates the efficient allocation of financial resources, which is crucial for economic growth and productivity. Banks and other financial institutions play a pivotal role in intermediating funds between savers and borrowers, supporting investment and consumption activities that drive economic expansion. In times of financial distress, such as banking crises or asset price bubbles[2], the flow of credit can be disrupted, leading to economic downturns and instability.

Macroeconomic policies, such as monetary and fiscal measures, also influence financial stability. As part of their price stability mandate, central banks use monetary policy tools, such as interest rates and reserve requirements, to manage inflation which is also essential for financial stability. Fiscal policies, including government spending and taxation, can also impact the financial soundness of financial institutions and the efficient functioning of markets by affecting aggregate demand and investor confidence. Policymakers must therefore adopt holistic approaches that consider the interactions between macroeconomic and financial stability variables, in order to promote sustainable economic growth and mitigate risks to financial stability.

3.2 Governance

To promote effective decision-making and coordination among relevant stakeholders responsible for financial stability, it is essential to have in place a robust financial stability governance framework. A well-articulated governance framework helps to underline the overall objective and the responsibilities of the various stakeholders to better manage expectations. Nonetheless, a country's characteristics need to be considered when choosing the most effective institutional arrangements for promoting financial stability.

In line with international best practice, a robust financial stability governance framework must as a minimum have a sound legal basis. The enactment of the Financial Stability Act in December 2023 was an important milestone, as it enshrined the country's financial stability governance

[2] This refers to periods of rapid and unsustainable increases in the prices of assets such as real estate or commodities, followed by a sudden collapse.

framework in law. The Act has clearly articulated the objective and mandate of the FSC as a public body which is tasked with the financial stability oversight of the country with the aim of promoting a stable financial system. Further information on the role and mandate of the committee is presented in Section 4 of this report.

3.3 Prudential and Regulatory Frameworks

The implementation of international standards and codes and regular assessments of the degree of compliance with same, reinforce the foundation of the domestic financial system. The main standards in the banking sector consists of the Basel Core Principles (BCP) and relevant risk-based frameworks. For the non-banking sector, the main standards relate to the Insurance Core Principles (ICP) of the International Association of Insurance Supervisors (IAIS) and the principles of securities regulation from the International Organisation of Securities Commissions[3] (IOSCO). Other standards that are applicable to all financial institutions include governance and Anti-money Laundering and Countering the Financing of Terrorism (AML/CFT).

Prudential and supervisory frameworks aim to enhance the financial soundness of individual institutions with the ultimate objective of strengthening the resilience of the overall financial system. In promoting domestic financial stability, regulatory authorities need to ensure that the existing frameworks are largely adhering to international standards given the dynamic nature of the financial landscape. Consequently, domestic regulatory authorities continue to work towards the adoption of a more targeted approach to both supervision and regulation, through the implementation of risk-based frameworks.

The financial stability framework of the country is in the initial stages of development, whereby the focus is on establishing the basic foundation necessary for relevant authorities with financial stability oversight, to develop robust frameworks to safeguard the stability of financial institutions, infrastructures and services under their jurisdiction. Prior to the implementation of such frameworks, comprehensive revisions to the legislative structure of relevant authorities will need to be undertaken.

3.4 Financial Safety Nets

According to international best practice, it is important for authorities to have in place effective mechanisms for crisis preparedness and management, as well as financial safety nets to minimise

[3] IOSCO is the international standard setting body for securities regulators.

the adverse effects of systemic shocks and reduce the burden on the economy and taxpayers. Regulatory authorities are required to have in place the necessary frameworks to detect emerging stress in financial institutions and markets, including the development of adequate contingency planning and intervention arrangements. An example of international standards relating to financial safety nets are the Financial Stability Board's (FSB) "Key attributes of effective resolution regimes for financial institutions". These are a set of the core elements that are considered to be necessary for the effective resolution of financial institutions in an orderly manner with minimum cost to taxpayers, while maintaining continuity of their vital economic functions. Another example is the "Core principles for effective deposit insurance systems" by the International Association of Deposit Insurers' (IADI), which aims to protect depositors and contribute to financial systems stability. It is important to note that a practical and proportionate approach should be adopted in the application of international standards to cater for the idiosyncratic characteristics of jurisdictions.

In the context of Seychelles, work remained ongoing in enhancing the financial safety nets of the country, namely the banking sector resolution framework and CBS' lender of last resort function. Once completed, it is envisaged that the domestic financial system will be better placed to manage and minimise the impact of financial stability shocks. Whilst regulatory authorities work towards implementing the relevant mechanisms, inter-agency cooperation is key to preventing and managing systemic events, including other contributing factors such as:

I. EARLY INTERVENTION

Regulators maintain a proactive stance, identifying and addressing potential risks prior to escalating into systemic threats.

II. TRANSPARENCY AND COMMUNICATION

Regular communication channels between regulators, financial institutions, and stakeholders ensure timely dissemination of information.

III. CONTINUOUS EVALUATION

Regulatory frameworks undergo periodic reviews and updates to adapt to evolving market dynamics and emerging risks.

3.5 Risk and Vulnerabilities

The early identification of risks and potential sources of vulnerabilities in the financial system is one of the essential pillars to safeguarding financial stability. As per international best practice, establishing early warning mechanisms, which includes conducting regular and systematic assessments of vulnerabilities, increases the effectiveness of mitigating measures. As a prerequisite to undertaking such periodic assessments, regulatory authorities must ensure the availability of relevant and accurate data.

Although there are various tools available for assessing risks to the domestic financial system, there is a need to enhance those instruments for the effective identification and monitoring of systemic risks. This has prompted work towards the development of effective quantitative and qualitative analytical tools and models, namely heat maps[4], stress testing[5] and financial stability indicators[6], which are anticipated to be operational in the short to medium term. These instruments will enable the identification and monitoring of risks across the domestic financial system and assist with addressing deficiencies in the current frameworks. As a result, this will help to improve policy recommendations, necessary to enable policy makers to make more informed decisions.

[4] Graphical tool used to show different level of risks to the financial system.
[5] A tool used to assess the potential impact of shocks on a set of financial variables.
[6] A set of indicators used to assess systemic risks in the financial system.

4 Financial Stability Governance Framework

Good governance is vital for effective decision making, exchange of information and coordination amongst relevant stakeholders with the responsibility of promoting financial stability. A robust governance framework is thus essential for maintaining financial stability, as good governance remains at the core of a stable financial system. Moreover, such a framework should have a sound legal basis and be anchored on international best practices and standards, while considering the local context of the jurisdiction. This section presents progress made towards enhancing the country's financial stability governance framework.

4.1 Establishment of the FSC

The FSC was established as an advisory body in March 2016 by order of the President of the Republic, with the broad mandate of promoting financial stability within the domestic economy. The Committee chaired by CBS, consists of members from the Ministry responsible for Finance, FSA, and FIU.

Although the FSC was operating as an advisory body with soft powers, the financial stability mandate was not explicitly defined and allocated to the respective authorities, which based on international best practice is required for implementing effective decision-making and coordination among relevant stakeholders. Moreover, the absence of clearly outlined financial stability objectives in the member institutions' mandates, further highlighted the need to address the identified deficiencies. Consequently, efforts were directed towards strengthening the financial stability framework, with an initial focus on enhancing the governance structure in line with international best practices. The enactment of the Financial Stability Act, 2023, was the first step towards establishing a strong legal framework, which would provide clear institutional arrangements to facilitate collaboration between regulators.

The Financial Stability Act, 2023, highlights key areas, namely the financial stability mandate, the designated powers, the role and responsibilities of the respective stakeholders, coordination mechanisms, accountability and exchange of information, which forms the basis of an effective governance framework.

The provision of a clear mandate for financial stability and adoption of semi-hard powers, will allow the Committee to take action and make formal recommendations. Additionally, the law makes provision for the First Deputy Governor of CBS to be a member of the FSC, in the capacity as the bank regulator. This is in line with international best practices on governance and ensures equal representation across FSC membership, for banking and non-banking regulators. This change in composition of the FSC will allow representation of the dual role of CBS, namely responsibility for monetary and exchange rate policies and supervisor and regulator of the banking sector.

Ensuring relevant stakeholders understand their roles and have effective coordination mechanisms in place, allow for common policy objectives to be set with the ultimate aim of promoting financial stability. The functions of the FSC are listed in Figure 2, as per section 7 of the Act.

Figure 2: Functions of the FSC

(a) monitor risks and vulnerabilities to the financial system;

(b) devise the country's financial stability policy strategy;

(c) provide policy guidance to a specific member for consideration in the institution from which he or she is drawn or upon request by the Cabinet of Ministers

(d) collect information and statistical data from members and other bodies that the Committee deems relevant to the furtherance of financial stability;

(e) identify and assess risks to financial stability;

(f) monitor domestic and international financial regulatory developments;

(g) recommend improvements in areas that enhance the integrity, efficiency, competitiveness, solvency and liquidity of financial institutions and the financial market;

(h) facilitate information sharing and coordination amongst its members regarding the content of and manner in which the following is to be carried out in each member institution —

> (i) financial policy development;
>
> (ii) assessments;
>
> (iii) examinations;
>
> (iv) reporting requirements; and
>
> (v) enforcement actions;

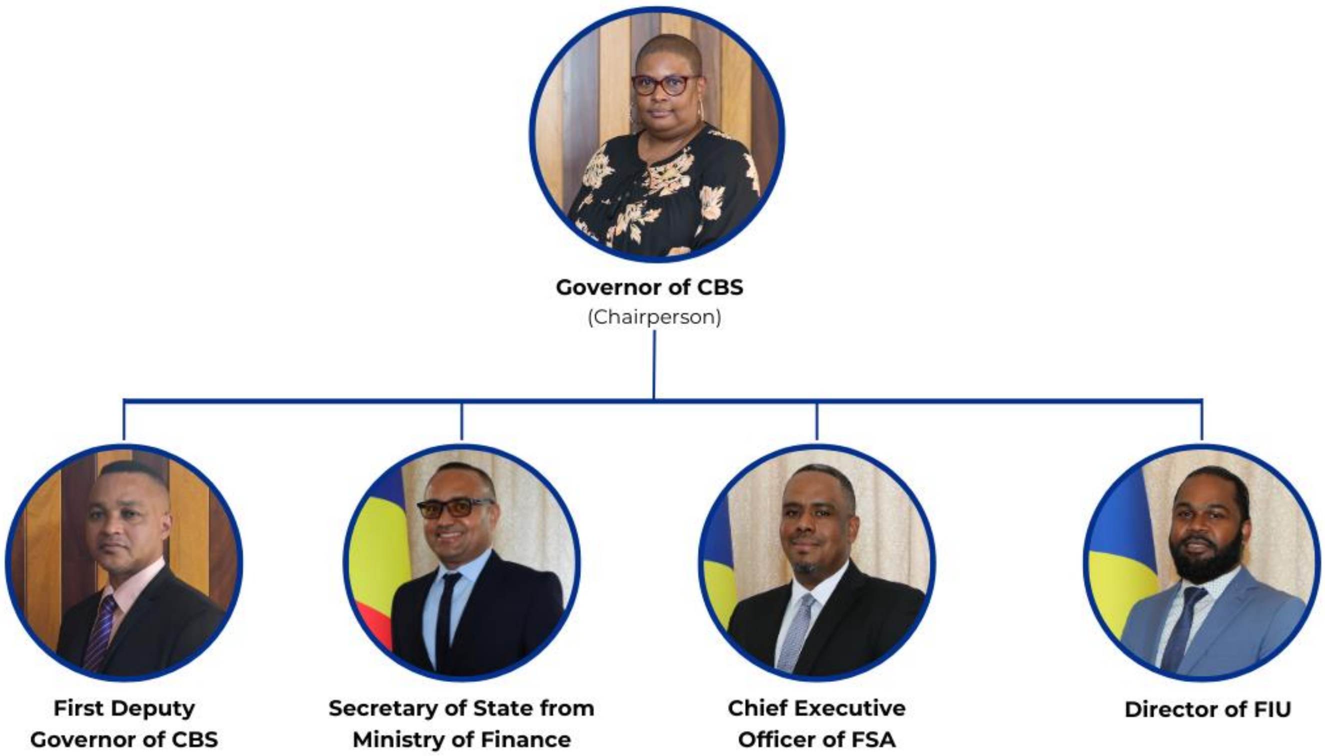
(i) identify general priorities and principles which the member institutions are encouraged to prioritise;

(j) identify and mitigate gaps identified in skills, expertise, directives, legislation and practices; and

(k) promote the development of effective crisis management and the implementation of a coordinated response to financial crises.

To promote accountability and transparency, the Act requires that a report is submitted to both the President and the National Assembly, six months after the end of each financial year. This is in addition to the existing periodic media correspondences whereby a summary of the quarterly FSC meetings is provided. Lastly, the Financial Stability Act, 2023, contains provisions aimed at encouraging data sharing by ensuring access to timely and reliable information for assessment of vulnerabilities and risks to domestic financial stability. These provisions play a pivotal role in setting a conducive environment for maintaining financial stability, and essentially nurturing economic resilience and safeguarding the interests of all stakeholders in the domestic economy.

Figure 3: Current composition of the FSC



4.2 Establishment of the FSC Technical Subcommittee

A Technical Subcommittee was formally established in January 2023, comprising of technical staff from the FSC membership institutions. The main objective of the FSC Technical Subcommittee is to support the FSC in effectively delivering on its mandate. The Subcommittee operates under a Terms of Reference, endorsed by the FSC, which provides a structured approach to its functions and operational framework.

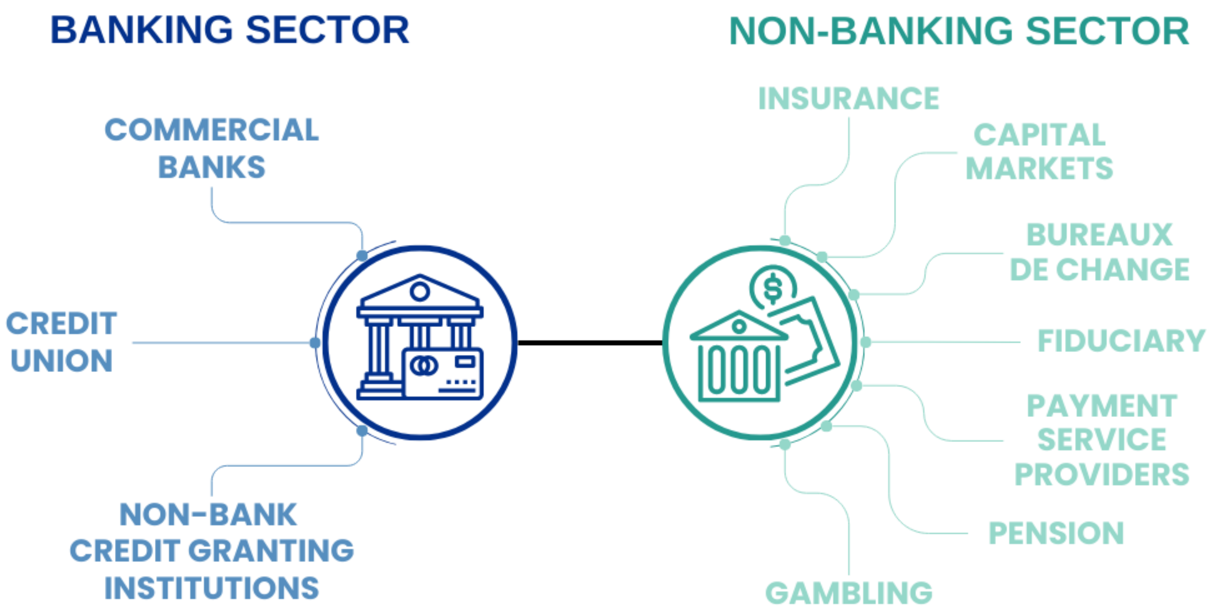
Functions of the Subcommittee include: conduct research and assessments on relevant risks that pose a threat to domestic financial stability, undertake forward-looking analysis that will assist in advising the FSC on current and emerging risks, and propose policy recommendations based on relevant analyses conducted.

In order for the Subcommittee to effectively perform its functions, there is a need to enhance the qualitative and quantitative analysis conducted to include forward-looking elements, such as stress testing and early warning indicators or assessments with a bearing on financial stability. Moreover, to assist in the analysis and identification of vulnerabilities in the financial system, a range of financial stability indicators is anticipated to be developed. Such tools will enable the Subcommittee to have sight of the financial system's health and any emerging instabilities and imbalances. Moreover, through inter-agency cooperation and consultation, the Subcommittee will be better equipped to make policy recommendations, propose mitigating measures, and develop macro-prudential tools, which contribute towards ensuring a harmonised approach to risk management.

5 Systemic Risks in the Financial System

A stable financial system plays an important role in the economy by facilitating the flow of financial resources from parties with surplus funds to those in need of funds, hence promoting economic growth. In serving their financial intermediation roles, banks and non-banks are exposed to numerous risks that can impact their operations and overall financial soundness. These risks can have systemic implications, potentially affecting the broader stability of the financial system and the economy. A risk is considered to be systemic if it significantly threatens the stability and resilience of the financial system by jeopardising its primary role of financial intermediation and disrupting the economy as a whole.

Figure 4: Composition of the Seychelles Financial System



Systemic risks arise from the interconnectedness between financial institutions, markets and infrastructures within the financial system, which amplifies the impact of the initial risk event. Systemic risk events can be sudden and unexpected, or as a result of a build-up in vulnerabilities over time in the absence of relevant policy responses. This section outlines the main types of risks faced by the country's financial system and briefly presents the different measures being implemented, in line with international best practices, to manage and mitigate those risks.

5.1 Banking Sector

Credit Risk

As financial intermediaries, the main risk banks face is credit risk, based on their core business of granting credit. Credit risk occurs when the borrower or counterparty fails to meet its payment or contractual obligations in accordance with the agreed terms. The default of borrowers on their loan repayments, could result in erosion of incomes and ultimately profits, potentially resulting in material financial losses, adversely impacting the solvency of banks. Exposure to credit risk can emerge from both external and internal sources. An example of the former is adverse changes in macroeconomic conditions such as contractions in economic activity or sudden economic shocks, as observed during the COVID-19 pandemic, impacting borrowers' (both households and businesses) ability to honour their loan obligations, as a result of a loss of income. Internal sources of credit risk stem primarily from factors within the bank's control or related to its operations and management. These include ineffective and inadequate credit risk management policies, overexposure to specific economic sectors, inadequate assessment of collateral values and provisioning for potential loan losses.

The indicator commonly used to measure banks' exposure to credit risk is the ratio of non-performing loans (NPLs) to total loans. This ratio quantifies the share of loans within a bank's portfolio that are not being repaid, compared to the total outstanding loans. A higher ratio indicates a higher level of credit risk, as it suggests that a significant portion of the bank's loans may not be fully recovered, which may adversely impact a bank's profitability and solvency.

The Basel Framework[7], is the key set of international standards for addressing credit risk in the banking sector and consist of a combination of regulatory requirements, effective risk management frameworks, and prudent lending practices. Whilst banks are required to establish internal credit policies and risk controls, as the regulatory and supervisory authority of banks, CBS issues guidelines and regulations, in line with the Basel Framework, which serve as guidance to banks on different aspects of credit risk management. The main regulations issued by CBS relates to credit classification and provisioning as well as directives on large exposure, credit concentration and connected lending. To note that CBS ensures compliance to the aforementioned guidelines and regulations using a range of measures, namely through periodic

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[7] Refers to the full set of standards of the BCBS, which is the primary global standard setter for the prudential regulation of banks.

and ad-hoc data collection as part of its offsite monitoring, regular communication with respective financial institutions and onsite examinations.

Liquidity Risk

From a banking sector perspective, liquidity risk is the risk that a bank may not be able to meet its short-term obligations as they come due, namely allowing withdrawal of deposits by customers, or funding its day-to-day operations. This occurs as a result of the inability to quickly convert assets into cash (known as asset liquidity risk) or obtain funding at reasonable terms (referred to as funding liquidity risk). Similar to credit risk, liquidity risks can arise from both external and internal sources. Liquidity risk arising from an external source can be caused by the sudden and large-scale withdrawal of deposits by customers, triggered by an economic shock, causing liquidity issues whereby banks have insufficient funds to meet demand for withdrawals. Notable examples of internal sources of liquidity risk include banks not having adequate liquidity management and monitoring systems in place and holding large investments in assets that are not easily converted into cash, known as illiquid assets. These factors can impair the liquidity position of banks, leading to solvency concerns, which in turn can undermine depositor confidence, disrupt financial intermediation and threaten stability of the financial system.

Two key indicators used to measure liquidity risk is the ratio of broad liquid assets to short term liabilities and the liquid assets to total liabilities ratio. The latter ratio is a regulatory requirement, measuring the bank's capacity to cover its total liabilities with readily available liquid assets, whereas the former measures the bank's ability to cover its short-term obligations with readily available liquid assets. A high ratio indicates that a bank has sufficient liquid assets to meet its short-term liabilities (e.g. deposits and maturing debts) and is resilient to liquidity shocks.

The Basel Committee on Banking Supervision (BCBS) provides guidance on liquidity risk management, including maintaining sufficient liquid assets, diversifying funding sources, establishing contingency funding plans, and conducting stress tests to assess banks' resilience to liquidity shocks. Regulators also play a crucial role in the oversight of banks' liquidity risk management practices and adherence to regulatory requirements. To ensure banks maintain adequate liquidity buffers to withstand adverse liquidity conditions, CBS through the Financial Institutions (Liquidity Risk Management) Regulations, 2009, require banks to maintain liquid assets in an amount which shall not, as a daily average each month, be less than 20 per cent of the bank's total liabilities. The aforementioned information is submitted on a weekly basis to CBS, whereby supervisors ensure compliance to the regulatory limit. Moreover, as part of its monetary policy framework and to promote financial stability, CBS also provides liquidity support to banks through credit facilities, such as the overnight credit facilities and the emergency lending facility, respectively. Periodic stress testing exercises are also conducted to evaluate the banking sector's resilience to adverse liquidity scenarios.

Operational Risk

Operational risk is defined as the risk of loss resulting from inadequate or failed internal processes, people and systems or from external events. Operational risk relates mostly to challenges stemming from system failures, technology disruption, inadequate Information Technology (IT) infrastructures due to outdated systems and cybersecurity threats via electronic banking services, for example point of sales and automated teller machines. Operational risks can also be triggered by human error, such as processing errors by employees, as well as fraudulent activities by employees or customers. Banks' operations can also be disrupted by various external events, such as natural disasters, supply chain disruptions and cyber-attacks, resulting in increased exposures to operational risk.

Effective monitoring of processes is essential to the adequate management of operational risk by banks, which enables prompt detection and correction of deficiencies in associated policies, processes and procedures. As the banking sector regulator, CBS is responsible for establishing and implementing robust regulatory frameworks that outline guidelines and requirements as well as setting standards and best practices for managing operational risk in the banking sector. In addition to the comprehensive cybersecurity guidelines issued to banks on how to respond to cyber threats, CBS also conducts simulation exercises to assess the resilience of Financial Market Infrastructures (FMIs)[8] to cyber threats and other operational disruptions. Furthermore, coordination between relevant stakeholders is ensured through the establishment of cybersecurity working groups to facilitate information sharing. Both the banks and CBS are engaged in disaster recovery and business continuity planning to enable quick recovery and minimise system downtime. Other mitigating measures include regular IT updates of all systems and software to address vulnerabilities and protect internal systems.

[8] Bank for International Settlements defines FMIs as a multilateral system among participating institutions, including the operator of the system, used to clear, settle, or record payments, securities, derivatives or other financial transactions.

Market Risk

Market risk generally arise from a bank's investment activities. It is the risk of loss in on and off-balance sheet positions of banks arising from movement in market prices. Common sources of market risks are volatility in exchange rates and interest rates, thus exposing banks to foreign exchange risk and interest rate risk, respectively. In principle, unexpected movement in exchange rates may prompt financial losses for banks on their foreign currency assets. Similarly, unforeseen fluctuations in interest rates may trigger financial losses for banks on their interest rate-sensitive assets.

Addressing market risk in the banking sector involves implementing robust risk management practices aligned with international standards. With the aim of minimising banks' foreign exchange exposures by limiting the share of assets and liabilities being held in foreign currency, CBS has prescribed prudential limits on banks long and short foreign currency positions through the Financial Institutions (Foreign Currency) Regulations, 2009. Moreover, CBS has implemented risk monitoring and daily reporting mechanisms to ensure compliance with the established limits. Another tool employed by CBS to provide liquidity to domestic financial institutions facing temporary shortages or funding constraints in foreign currencies, is the foreign exchange auction from its Monetary Policy Framework.

5.2 Insurance Sector

Credit Risk

Credit risk from an insurance sector perspective is the risk that an insurance company may incur losses from a third party or counterparty failing to make payments when they are due. For example, when a policyholder fails to make payment on an extended line of credit for premiums owed to the insurer, the profitability of the insurance company is negatively impacted. Furthermore, credit risks may arise when reinsurance companies fail to pay reinsurance recoveries to the ceding insurer[9] in a timely manner. This happens mainly because the common market practice is that the ceding insurer pays out insurance claims to policyholders before seeking consent from the reinsurer when assessing the claim.

[9] Ceding insurer is an insurance company that passes a portion, or all of the risk associated with an insurance policy to a reinsurer.

As the regulator of the insurance sector, FSA, conducts ongoing monitoring of financial statements and management accounts along with quarterly reports from the insurers as a means of identifying, assessing, and managing the risks associated with credit exposures. This aligns with the standards set by the IAIS in relation to ICP 9 Supervisory Review and Reporting. As per the aforementioned principle, insurance regulators are recommended to use offsite monitoring and onsite inspections to evaluate insurance companies' financial condition, corporate governance framework, overall risk profile, and compliance with relevant legislation and supervisory requirements. Such information allows for effective supervision of insurers and evaluation of growth and deficiencies of the insurance market.

Market Risk

Market risk arises from insurers exposure to fluctuations in interest rates, exchange rates or market price of an invested asset (e.g. equity values[10]). Two common types of market risk which insurers are exposed to are:

Interest Rate Risk

Changes in interest rates exposes insurance companies to interest rate risks. These fluctuations result primarily from the re-pricing or devaluation of assets and liabilities. The insurer can invest in properties to diversify their portfolio, and due to external factors, the value of these properties may drop from its pre-determined value and invertedly cause the company to incur a loss.

Foreign Exchange Risk

This is due to volatility in exchange rates, whereby the insurer's exposure originates from its foreign currency investments. If an insurer invests in foreign currency stocks, depreciation of the foreign currency in which the stocks are held can affect the gains anticipated from the investment, resulting in financial loss for the insurance company.

To mitigate such risks, FSA ensures that insurance companies are adequately capitalised, should such uncertainties materialise. This is monitored through analysis of management accounts and quarterly reporting requirements.

[10] Equity value constitutes the value of the company's shares and loans that the shareholders have made available to the business.

Insurance Risk

Insurers are exposed to insurance risk if they have inadequate or inappropriate reinsurance, financial reserves, underwriting, claims management, product design and pricing.

Insurance risk in terms of product design and pricing risk relates primarily to the exposure of insurance companies to financial loss arising from the re-pricing or inadequate pricing of certain products. This in turn may have an adverse impact on the gross written premium and overall net profit.

In the most developed insurance markets, insurance pricing has become extremely refined as insurers utilise big data[11] and a variety of predictive analytical scoring models. Big data can be used to benefit customers by allowing more tailored insurance solutions or more accurate risk pricing. In Seychelles, this is a relatively new concept and there is a need for continued financial consumer education, protection, and development of inclusive insurance products.

Another significant insurance risk is underwriting and liability risk which arises from insurance contracts or what is called 'insurance policy' from which customers seek to transfer various financial uncertainties to the insurer in exchange for a set of premiums levied by the insurer. As such, underwriting and liability risk is an inherent risk for the insurers' operations and arise from the selection of risks to be insured. Underwriting risks consist of the perils such as mortality, longevity[12], sickness or disability, fire, weather, collision, etc, which are vital to underwriting procedures by the insurer.

One mitigating measure that FSA as the regulator requires from insurers, is to provide actuarial analysis and reports when designing and pricing products. This ensures that appropriate steps are undertaken to provide customers with valuable products and adequate pricing. Furthermore, insurers are obligated to have appropriate internal controls such as procedure manuals and guidelines in place, for underwriters to ensure risks are fairly underwritten so as to mitigate any further risks. This aligns with ICP 8, which requires insurance companies to establish and operate within an effective and documented system of internal controls. The Insurance Act 2008, as amended, makes provisions for the insurer to submit reinsurance treaties to FSA for prudential review. Furthermore, FSA has the authority to review and provide approvals for products, which ensures customers are being provided with fair and valuable insurance contracts.

[11] Data sets that are too large or complex to be dealt with using traditional data processing methods.
[12] Duration of an individual life

Operational Risk

Operational risk is defined as the potential loss due to the failure of people, processes, or systems and has been identified by insurance supervisors as a major cause for the failure of many insurers. As a result, there is considerable research into the appropriate supervisory approaches, namely, Enterprise Risk Management (ERM), capital requirements and supervisory review for mitigating operational risk. ERM frameworks assess and monitor risk from all sources for the purpose of increasing the insurers' financial viability. The IAIS ICP 16 Enterprise Risk Management for Solvency Purposes provides guidance for insurance regulators, whereby it requires insurers to establish an ERM framework for solvency purposes within its risk management system, to identify, measure, report and manage the insurer's risks in an ongoing and integrated manner.

Sources of operational risk for insurance companies are deficiencies in internal controls or processes, technology failures, human errors and natural catastrophes, which can disrupt an insurer's operations and result in loss of profitability and consumer trust.

FSA requires insurers to submit internal control and procedure manuals, in line with the ICP 8 and Code on Risk Management and Internal Controls issued to the industry in 2018. The adherence and effectiveness to the aforementioned manuals are verified during offsite and onsite inspections conducted by FSA. Moreover, the manuals are continuously updated to reflect current market conditions.

Liquidity Risk

Liquidity risk in insurance, originates from the inability of an insurer to access operating funds without incurring unacceptable losses. The failure of a large global reinsurer might have systemic implications for the domestic insurance industry, specifically in accessing required funds to settle outstanding claims.

In the IAIS' principles on capital adequacy and solvency, ICP 10 underlines the importance of risk management and the need for capital adequacy and solvency regimes to be supplemented by risk management systems. The indicator used to measure the liquidity position of an insurer as per FSA's early warning test is the liquidity ratio, which considers the cash, treasury bills, term deposits and investments of the insurer vis-à-vis their total liabilities. The accepted threshold of the ratio, for the insurer to be deemed liquid is less or equal to 95% and a ratio below the minimum requirement would indicate that the insurer has liquidity issues.

In 2018, FSA issued a code on risk management and internal controls to the insurance industry. This code was implemented with the aim of addressing the need for a functioning internal risk management system. It also required insurers to examine the status of their current risk management by setting up appropriate function and processes. The implementation of such measures has allowed FSA to enhance its onsite and offsite monitoring of its licensees. Additionally, the Insurance (Domestic Insurance Business) Regulations, 2009 ensure that provisions are set in place so that licensed insurance companies have enough capital.

Solvency Risk

Solvency, as far as an insurance company is concerned, refers to the company's ability to meet its financial obligations, particularly its ability to cover policyholder's claims and other liabilities as they come due. This is a prominent risk for the insurance sector, given its potential to disrupt the resilience of the insurance industry and compromise policyholders' interests. Measures employed by insurers to mitigate the risk of becoming insolvent consist mainly of holding diversified investment portfolios with varying liquidity profiles and maintaining technical reserves and reinsurance treaties to meet any liabilities that they may face. These measures serve as safeguards in mitigating the risk posed by such an event.

As per ICP 17 relating to capital adequacy, the supervisor must establish capital adequacy requirements, whereby all insurers have to maintain adequate capital reserves to cover potential losses and meet their statutory obligations to policyholders. Through a proactive, risk-based approach of supervising the sector, FSA conducts offsite data analysis, risk profiling prior to onsite examinations and ongoing monitoring and reviews as applicable. Additionally, FSA is guided by the Insurance (Domestic Insurance Business) Regulations, 2009, to ensure that provisions are set in place to safeguard the solvency of licensed insurance companies.

5.3 Gambling Sector

Money Laundering and Terrorism Financing Risk

The key risk exposures of the domestic gambling sector are those associated with Money Laundering and Terrorism Financing (ML/TF), given the prevalence of cash transactions within this sector. ML/TF risk is the exposure of an organisation's services or products to launder money or to finance acts of terrorism. As the regulator, FSA must ensure that the gambling sector understands the critical importance of heightened vigilance in combating money laundering. This includes implementing enhanced due diligence measures and submitting suspicious transaction reports to FIU, when necessary. These due diligence measures are mandatory for casinos and slot operators and consist of effectively identifying and monitoring customers' behaviour and establishing anti-money laundering procedures designed to identify customers. Additionally, gambling establishments must ensure the declaration of a person's identity and the source of funds being used.

As guided by the International Association of Gaming Regulators (IAGR), FSA enforces these stringent compliance measures to mitigate the exploitation of illicit financial activities that could undermine the country's financial integrity and reputation, which may result in broader systemic consequences. Additionally, FSA is actively working towards its own jurisdictional technical standards for the industry in line with international best practices that would result in better oversight.

5.4 Capital Markets Sector

Reputational Risk

Reputational risk refers to the threat of negative public or stakeholder opinion regarding the organisation's credibility and reputation and is a major concern within the capital markets sector. This is due to the significant implications associated with negative perception and reputational damage. In the local context, this risk mainly emanates from unlicensed entities misleading the general public with fraudulent websites and false affiliation claims with the jurisdiction, which have the potential to significantly harm the country's reputation and subsequently affect relationships with key stakeholders. Additionally, these deceptive practices could result in a loss of trust in both the investment market and the entire financial system.

To address this risk, as the regulator of the capital markets sector, FSA fulfils its supervisory responsibilities by identifying and taking appropriate actions against unlicensed entities. An important measure taken by FSA is to keep the public informed of such illicit activities to maintain transparency and ensure consumer protection. Furthermore, given the consistent growth of the sector and its vulnerability to such risk, FSA's monitoring approach involves guidance from IOSCO. As per IOSCO's recommendations, jurisdictions are encouraged to implement practices such as adequate licensing, regulation and supervision of entities operating in the securities sector, appropriate oversight and standards set for auditors and securities markets participants and the promotion of transparency through disclosure requirements and standards. To note, FSA conducts active monitoring of online platforms, with the aim of identifying fraudulent or unauthorised securities activities. The respective fraudulent websites are flagged and specific alerts are published by FSA to caution relevant stakeholders and the general public.

Another exposure to reputational risk arises from regulatory arbitrage largely due to the comparatively lower regulatory requirements within Seychelles' capital markets sector as opposed to jurisdictions such as the European Union (EU). This implies that the migration or set up of foreign head-quartered licensees further amplifies the potential for reputational risk and other related risks. As part of the mitigating measures in response to such exposures, FSA is engaged in a review of the substance requirements for licensees operating in the sector, which includes reviewing some of the prudential requirements, such as share capital levels, and increasing its supervisory inspections of licensees.

Market Risk

Market risk in the capital markets sector stems from sudden and unpredictable changes in prices or factors influencing market prices. This risk can emerge from political and economic events, and lead to market instability and a deterioration on investment returns due to increased uncertainty among investors. These disruptions can impact the functioning of the market and its participants, leading to spill-over effects across the broader economy. One monitoring tool employed by FSA is the analysis conducted on licensees' annual financial statements, however, the aim is to move towards a risk-based approach, in line with the IOSCO's principles.

Market risk is presently monitored by FSA through the review of risk management frameworks of licensed entities to assess the adequacy of the frameworks relative to the risks encountered. Going forward, FSA will move towards a risk-based approach to effectively monitor risks, including market risk, within the capital markets sector.

Money Laundering and Terrorist Financing Risk

Similar to other sectors, ML/TF risk is also present within the capital markets sector. The main source of ML/TF risk stems from international transactions conducted by licensees with institutions operating outside of Seychelles. Transactions with non-residents further expose the sector to the aforementioned risk, increasing the jurisdiction's exposure to reputational damage, which could adversely impact the ability of banks operating in Seychelles from securing correspondent banking relationships. To mitigate these risks, FSA ensures compliance with the AML/CFT Act, 2020, and its subsequent regulations, including providing guidance to licensees on AML/CFT best practices to ensure they have a clear understanding of their obligations and can implement effective mitigating measures.

5.5 Fiduciary Sector

Reputational Risk

The fiduciary segment of the domestic financial system is exposed to reputational risk stemming largely from Seychelles International Business Companies (IBCs). The country's exposure relates to its capacity in providing completed data request for the assessments conducted by the Organisation for Economic Co-operation and Development (OECD) to evaluate the jurisdiction's ability to exchange information for tax-related purposes. Failure to comply with the requirements may have an adverse impact on Seychelles' reputation as an international financial centre. Furthermore, the country must ensure it undertakes the prerequisite request, namely the Exchange of Information on Request (EOIR), from the Global Forum on Transparency and Exchange of Information for Tax Purposes, to minimise the risk of being rated as a non-cooperative jurisdiction for tax related purposes on the EU's list.

The fiduciary sector has progressively conducted regulatory reviews, namely through continuous collective efforts and commitment from the relevant stakeholders, to align with the international standards. Compliance inspections and checks are also conducted on a regular basis on the IBCs to ensure adherence with current legislative obligations, with enforcement action taken where required. The remedial actions aim to enhance the quality and reliability of information available in Seychelles, particularly concerning legal and beneficial ownership, and accounting records, which would subsequently improve the country's timeliness and accuracy to EOIR requirements.

Money Laundering and Terrorism Financing Risk

The sector is also exposed to ML/TF risk through the engagement of several IBCs with Virtual Assets (VAs), and Virtual Asset Service Providers (VASPs), which presents potential regulatory challenges in the absence of a legislative framework. The increasing exposure to VAs/VASPs in Seychelles, prompted the development of a regulatory framework for VAs/VASPs, which will enable the enforcement of appropriate action against any legal entities in contravention of the law. Such commitment will ensure that Seychelles is compliant with Recommendation 15 of the Financial Action Task Force (FATF) Standards, which requires VASPs to be licensed or registered for AML/CFT purposes and thereby mitigating reputational risk and safeguarding the country's financial stability.

Furthermore, the services and products of IBCs, trusts, foundations and limited partnerships are susceptible to ML/TF risk through misuse for unlawful purposes, facilitating corruption, tax fraud and other illegal activities. To mitigate such actions, the AML/CFT Act, 2020 and Beneficial Ownership Act, 2020 alongside other accompanying legislations, are continuously being improved to ensure that international best practices are being implemented. To enhance the effectiveness of the legislative framework in place, compliance reviews on IBCs, trusts, foundations and limited partnerships, as well as the trust and company service providers who administers such products, are continuously performed.

5.6 Conceptual Risks

Risks to financial stability are constantly evolving and emerging from sources that extend beyond the realms of economics and finance. Referred to as conceptual risks to financial stability, these potential threats to the stability and resilience of the financial system stem mainly from systemic vulnerabilities, regulatory failures or gaps, and emerging developments, such as technological innovation and climate change, which are yet to be adequately quantified and directly measured. Unlike traditional risks, such as credit and market risks, conceptual risks are often difficult to assess but can have significant implications for the soundness and functioning of the financial system and the economy as a whole. Identifying and addressing those risks is therefore crucial for maintaining the stability, resilience and functioning of the financial system over the long term. This section outlines key conceptual risks identified as potential threats to the stability of the country's financial system in the medium to long term.

Cybersecurity Risk

The growing reliance on digital infrastructures enhances the exposure of the financial system to cybersecurity risks, which as a result have attracted increased scrutiny from authorities. As evidenced by the rising cyber-related incidents globally, sources of cybersecurity risks are multifaceted, thus increasing the vulnerability of the financial system to such risks. As such, cybersecurity threats represent a widespread and evolving risk to the stability of the financial system, necessitating continuous investments in robust cybersecurity measures, enhanced threat detection capabilities and incident response protocols, including effective cooperation between relevant stakeholders. These measures aim to provide the necessary tools to mitigate the relevant risks and ensure the resilience of the financial system.

Cybersecurity risks arise from malicious activities targeting financial institutions, infrastructures and networks with the intent to disrupt normal operations, steal sensitive information, or manipulate financial transactions. Exposure to cybersecurity risk could result in financial losses for both customers and financial institutions and undermine trust and confidence in the financial system. Cyberattacks can lead to unauthorised access to sensitive customer information stored within financial institutions' databases. Cybercriminals may also attempt to steal funds or manipulate financial transactions through different techniques such as phishing, malware, or ransomware attacks. These attacks can disrupt the normal operation of financial services, such as online banking, payment processing, and trading platforms. Cyberattacks targeting financial markets or trading platforms can trigger market manipulation, leading to distorted market prices, undermined investor confidence, hence eroding the integrity of financial markets. Cybersecurity threats can also spread across interconnected financial systems, targeting FMIs, disrupting the functioning of financial markets and leading to liquidity shortages, market disruptions, impacting the broader economy.

The disruption of banking operations due to cyberattacks, often leads to system downtime, delays in transactions and service outages. Cyberattacks targeting banks can also trigger data breaches, resulting in unauthorised access, identity theft, or manipulation of sensitive customer data, such as account details and transaction records. Additionally, cybercriminals may use different techniques (e.g. phishing and malware) to exploit vulnerabilities in banking systems and processes to conduct financial fraud, such as unsanctioned transfers and fraudulent transactions. As a result, cyber threats can undermine customer trust in the banking sector, damage the reputation of banks and trigger investigations or penalties by regulatory bodies, potentially translating into financial losses.

Cyber threats in the non-banking sector can cause significant disruption in services and ultimately result in financial losses. In the insurance sector, a cybersecurity breach, such as a ransomware attack, could affect data security, prevent an insurer from processing claims efficiently as well as other functions, affecting the insurer's reputation and profitability. Another example of such malicious acts involves tampering with the securities market system, executing fraudulent trades, or disrupting trading platforms. These manipulative activities can distort market prices, erode investor confidence, and cause financial losses.

To address cybersecurity risks in the financial system, the International Organisation for Standardisation (ISO) and the International Electrotechnical Commission (IEC) have set the following standards and codes ISO/IEC 27001 and ISO/IEC 27035. The ISO/IEC 27001 is an international standard for information security management systems which provides a systematic approach for managing sensitive customer information, ensuring its confidentiality, integrity and availability. Through specific requirements relating to risk assessment and control, the standard helps financial institutions mitigate risks related to information security. The ISO/IEC 27035 standard focuses on information security incident management, providing guidelines to plan and prepare for incident response. Additionally, as part of the national effort to align the country with international best practices in combatting increasing cybercrimes, the modernisation of relevant legislative frameworks has taken place in recent years. A new and modern legislation, the Cybercrime Act, 2021, was enacted in December 2021 to replace the outdated Computer Misuse Act, 1998. In December 2023, the Data Protection Act, 2023, was enacted, replacing the Data Protection Act, 2003, providing regulations to protect individuals' personal data in line with the current digital environment.

Climate-related Risk

Financial institutions are increasingly being exposed to climate-related risks arising from both physical and transition risks. Physical risks relate to losses from climate-related events such as extreme weather conditions (e.g. floods, wildfires, and droughts) or shifts in climate patterns. Whilst transition risks stem from the shift towards a low-carbon economy and the implementation of policies aimed at reducing greenhouse gas emission.

In light of the climate-related risks highlighted above, there are significant implications for banks and non-bank financial services. The latter may be impacted by severe liquidity issues stemming from investments in vulnerable assets or industries, and reputational risks associated with inadequate response to climate-related challenges. It is important to note that despite the growing recognition of risks emanating from climate change, mitigation strategies within the non-bank sector remain nascent.

Similarly, banks are also vulnerable to the adverse impact of physical risks arising from climate-related events. This relates directly to banks' exposures in particular geographical area and/or to economic sectors vulnerable to climate change impacts, such as tourism and agriculture, which may experience higher loan defaults and impaired collateral values, subsequently impacting banks' profitability and solvency. As regards to transition risks, banks with significant exposure to carbon-intensive sectors, such as energy and transportation, are more at risk of being impacted through stranded assets and NPLs on their balance sheets. Banks can also be impacted by shifts in consumer preferences as the transition progresses. Nonetheless, addressing climate-related financial risks is crucial not only for safeguarding the financial soundness and resilience of individual institutions but also for promoting the sustainability and stability of the broader financial system.

To address climate-related risks, international best practices are progressively emerging, providing guidance for the integration of climate risk management into the operations and decision-making processes within the financial sector and beyond. By adopting best practices which takes into account climate-related risks, through comprehensive risk assessments, scenario analysis, enhanced transparency and disclosure, integrating climate risk into decision-making processes, and last but not least, promoting collaboration and engagement with relevant stakeholders, financial institutions can strengthen their resilience to climate change and contribute to a more sustainable and stable financial system. Example of international standards developed to address climate-related risks, include the IFRS S1 “General Requirements for Disclosure of Sustainability-related Financial Information” and the IFRS S2 “Climate-related Disclosures” issued by the International Sustainability Standards Board (ISSB). Another international organisation that is contributing towards enhancing the financial sector’s response to climate change is the Network for Greening the Financial System (NGFS). The network provides guidance, research and best practices for integrating climate-related risks into financial supervision and regulation.

Risks Associated with VAs

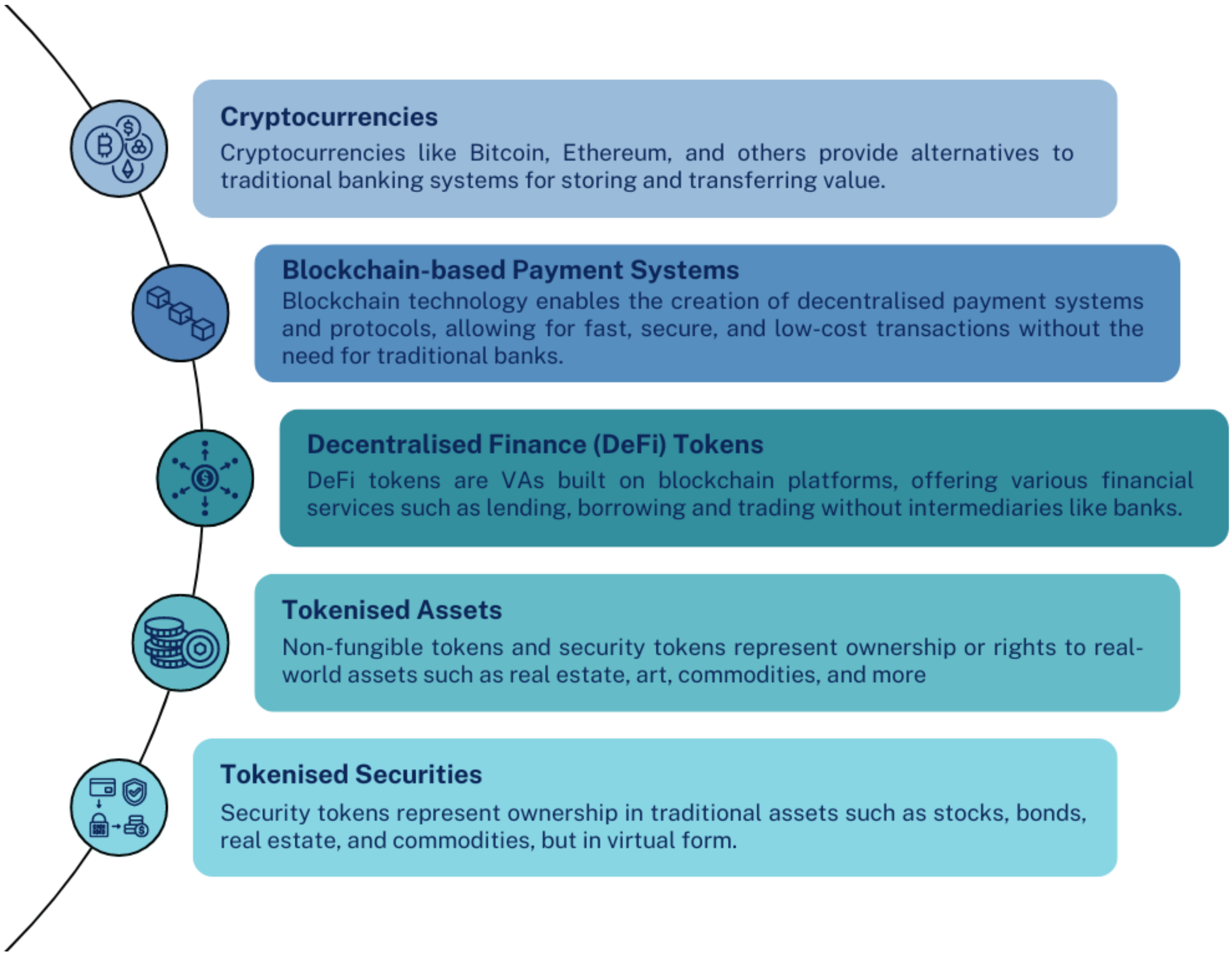
VAs such as cryptocurrencies or digital tokens have revolutionised the global financial landscape in recent years. VAs refer to any digital representation of value that can be digitally traded, transferred, and can be used for payment or investment purposes. Despite minimal interconnections with the traditional financial system, the emergence of VAs has the potential to pose key threats to the stability of the financial system, primarily due to the absence of robust supervisory and regulatory frameworks and the emergence of related risks factors such as those brought about by new technologies.

Owing to its heavy reliance on technology, VA transactions are highly vulnerable to cybersecurity threats, which exposes financial institutions engaged in VAs to higher operational risks relating to the integration of new technologies and the management of complex transaction processes. Moreover, VAs have been largely associated with illicit activities, such as money laundering, terrorism financing, and cybercrime. Their unique characteristics, including transactions made under false names, global accessibility and inadequate operational and regulatory frameworks, challenges the traditional/internationally accepted AML/CFT and Know Your Customer (KYC) requirements. VAs involves complex legal and compliance or regulatory considerations that financial institutions must comprehend to effectively combat financial crimes.

VAs pose numerous risks for banks, increasing their exposure to operational, reputational and cybersecurity risks, amongst others. As previously highlighted, banks may face operational challenges when dealing with the complexities of integrating VA services into their existing systems and processes. In terms of exposure to reputational risks, banks may also experience reputational damage if they are involved in or unintentionally facilitate illicit VA transactions. Banks may also become targets for cyberattacks aimed at accessing VA holdings or exploiting vulnerabilities in their VA-related systems and infrastructure. The evolving and fragmented regulatory landscape surrounding VAs can create compliance setbacks for banks engaging in VA-related activities, as they may face challenges in complying with evolving regulations related to VAs, such as AML and KYC requirements.

The use of VAs in the non-banking sector encompasses a broad range of activities and tools outside the scope of traditional banking systems, as depicted in Figure 5.

Figure 5: Examples of VAs and related activities



Whilst such technologies provide innovative solutions for individuals and businesses in various sectors, it poses significant risk such as cybersecurity risk, compliance risk, regulatory risk and operational risk, among others.

The new regulatory framework being developed domestically, will firstly mitigate ML/TF risks posed by VAs, addressing the FATF Recommendation 15. Moreover, it will enhance transparency and governance oversight of VASP, promote investor education and protection, strengthen cybersecurity measures, ensure prudential compliance and foster innovation in a well-regulated manner. Globally, several standards and codes have been introduced to address risks associated with VAs. The FATF Recommendations provide guidance on risk-based approaches to regulating VAs and VASPs including customer due diligence, transaction monitoring and reporting obligations. The BCBS Standard on Prudential Treatment of Crypto-assets offers guidance on the prudential treatment of crypto-assets by banks, including capital requirements, liquidity and risk management practices.

6 Highlights

SELECTED BANKING SECTOR INDICATORS

CBS

8 Commercial Banks

- 2 Locally owned commercial banks
- 2 Branches of foreign commercial banks
- 3 Subsidiaries of foreign commercial banks
- 1 Foreign-Owned commercial bank that is not a subsidiary or a branch. It was yet to commence operations at year end

2 Non-Bank Credit Granting institutions

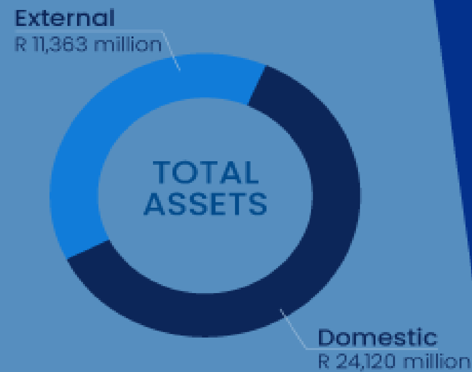
1 Credit Union

Non-Performing Loans (NPLs) ratio

An overall decline in the asset quality of banks driven by a rise in NPLs.

8.2%
DECEMBER 2023

NPL



Total assets to GDP

The banking sector maintained a relatively asset rich position vis-à-vis the economy.

DECEMBER 2023

129%

Top Five Sectors: Total Loans

- 17% Mortgage
- 14% Private Household
- 13% Tourism
- 9.1% Trade
- 7.5% Building & Construction

Top five sectors: NPLs

- 38% Tourism
- 13% Commercial Development
- 10% Agriculture & Horticulture
- 7.9% Transport
- 7.8% Building & Construction

Return on Equity

December 2023

28%

Return on Assets

December 2023

2.8%

Capital Adequacy Ratio

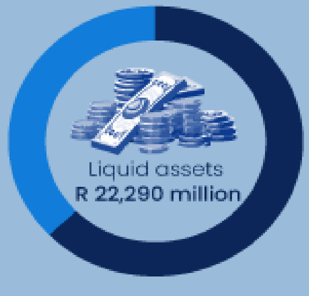
December 2023

21%

Minimum Requirement = 12%

Liquid assets to total assets (Broad)

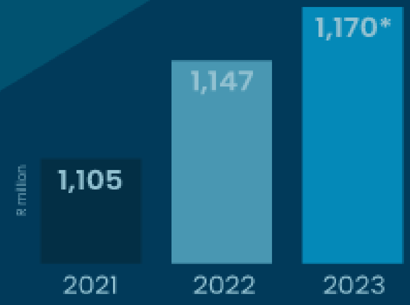
December 2023



Liquid Assets to Total Assets
62%

Disclaimer Data used for the selected banking sector indicators relate to unaudited figures.

SELECTED MACRO-ECONOMIC INDICATORS



Steady growth in the real GDP of the Financial & Insurance activities sector

*Indicative estimate

Source: National Bureau of Statistics and Seychelles Macroeconomic Framework Working Group

Real GDP of Financial & Insurance activities sector

Credit growth

2.8%

Credit-to-GDP

60% of Economic Activity Fueled by Credit

Inflation rate

DECEMBER 2023

-1.0% 12-month avg

-2.7% (YoY)

External Debt-to-GDP 29%

Total Public Debt-to-GDP 60%

DECEMBER 2023

Monetary Policy Rate

Policy rate stays 2.0% for three consecutive years.

CBS 2.0%

Average Savings Rate (YoY)

1.5%

DECEMBER 2023

Average Lending Rate (YoY)

9.7%

DECEMBER 2023

Exchange rate (Average)

DECEMBER 2023

SCR $ USD 14.22

SCR € EUR 15.55

Balance of Payments (Incl Offshore)

DECEMBER 2023

CURRENT ACCOUNT US$ -155 million

Foreign Exchange Exposure

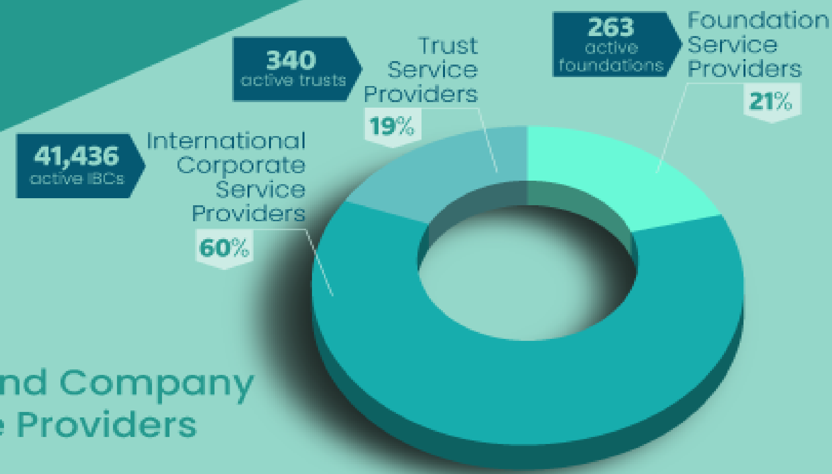
Total long position in FX to capital 5.9%

Total short position in FX to capital -2.8%

SELECTED NON-BANKING SECTOR INDICATORS

FIDUCIARY

Trust and Company Service Providers



INSURANCE

5 Insurance Companies

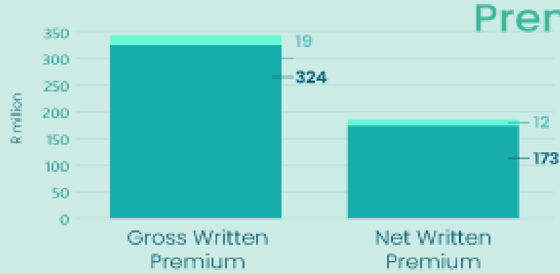
3/5 General

1/5 Life

1/5 Composite

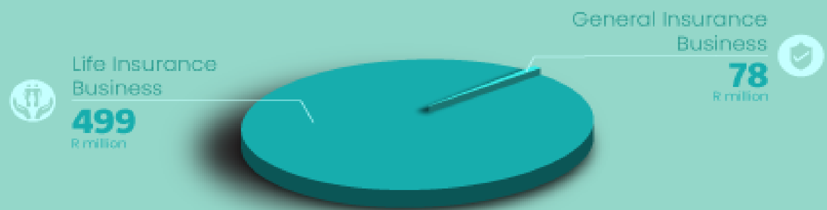
Premiums Written

December 2023



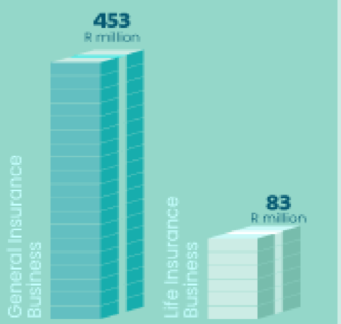
Net Claims Incurred

December 2023



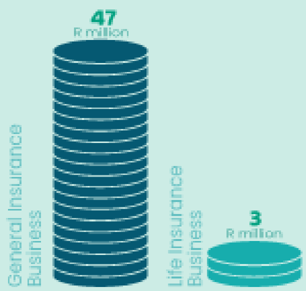
Total Assets

December 2023



Profit / Loss After Tax

December 2023



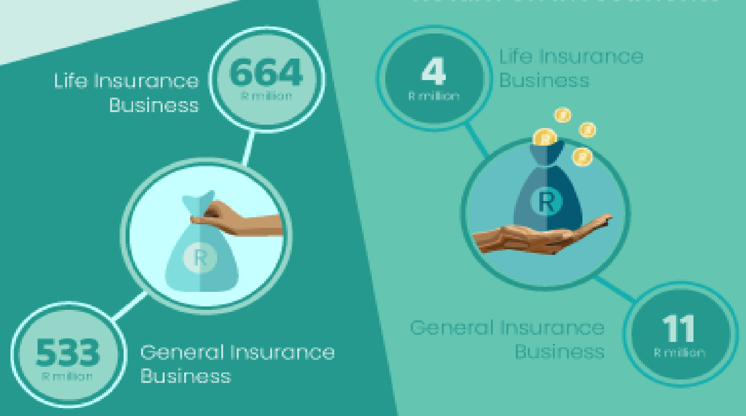
Technical Reserves

December 2023

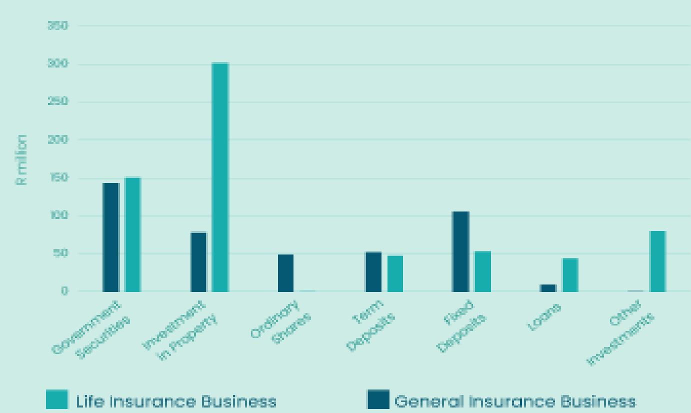
INVESTMENTS

December 2023

Return on Investments



Investment Allocation



Disclaimer: The analysis is not reflective of data captured from the insurance industry in its entirety, due to one non-response. The report is devoid of any data pertaining to the Gambling Sector.

CAPITAL MARKETS

Total Number of Licensees

Securities Exchange	2
Clearing Agency	2
Securities Facility	2
Securities Dealer	178
Investment Advisor (Individual)	0
Investment Advisor (company)	2

Number of licensees regulated under the Securities Act, 2007 as of December 2023, note all licensees within the sector are companies incorporated domestically by the Seychelles Company Registrar.

Fund Administrator	7
Private Fund	2
Professional Fund	6
Public Fund	1

Number of licensees under the Mutual Fund and Hedge Fund Act, 2008 as at December 2023.

Total Assets

Total Assets for licensees regulated under the Securities Act, 2007

US$ **2.4** million

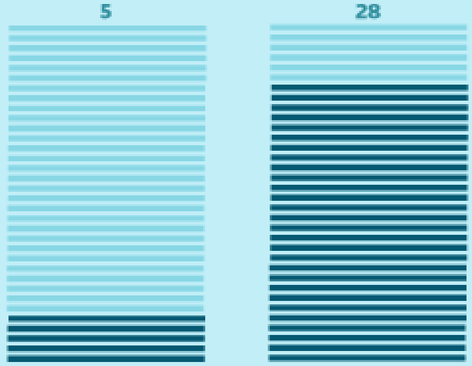
Profitability

Licensees regulated under the Securities Act, 2007

Gross profit	US$ **1.23** million
Net profit (after tax)	US$ **0.53** million

Listings

December 2023



Market Capitalisation

Market Capitalisation is the total value (number of shares multiplied by number of shares) of the companies listed on the Securities Exchanges

US$ **856** million

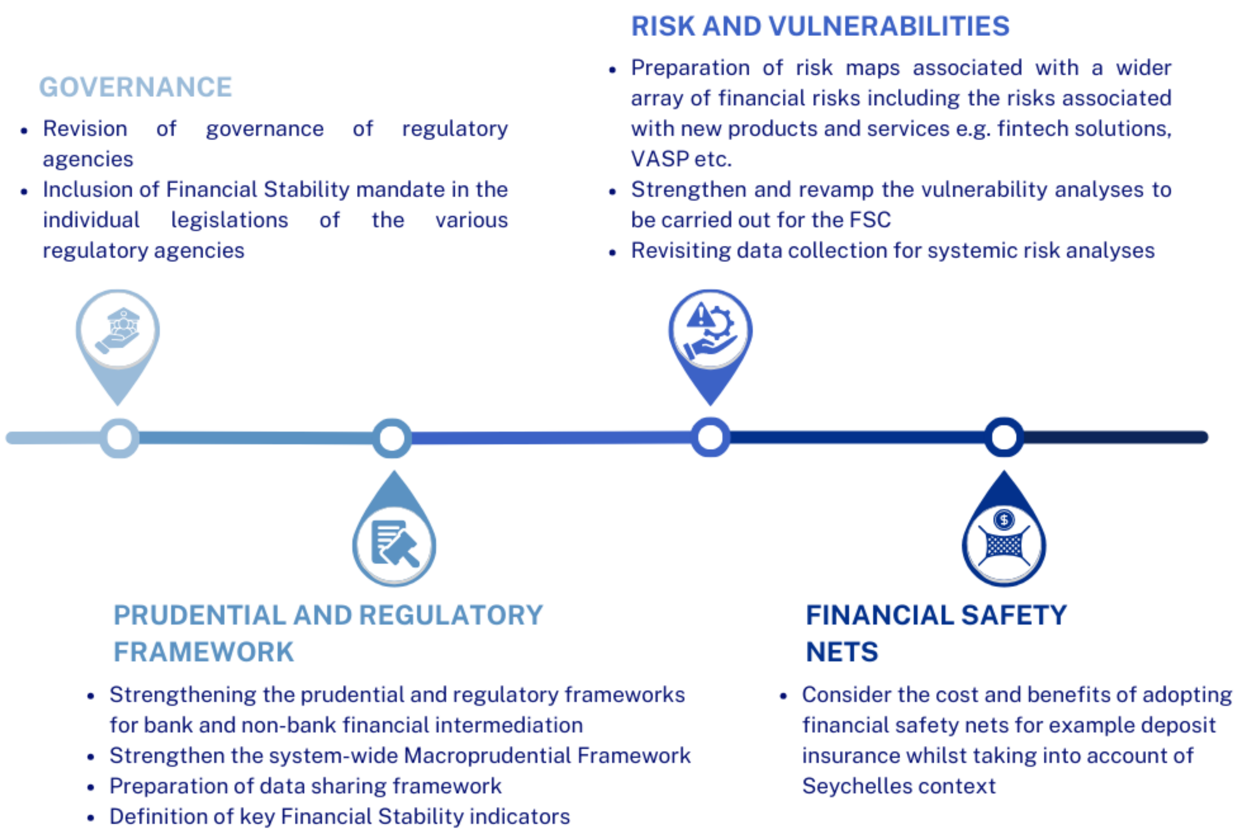
Disclaimer

Data compiled for the Capital Markets Sector is solely based on the responses received on a sector specific questionnaire issued in March 2024. It does not incorporate any post-audit data and may differ from subsequent reports published after completion of same, nor does it feature a 100% response rate. Findings presented herein should be interpreted with consideration had to this limitation.

7 Way Forward

Overall, it is critical to ensure that the domestic financial system remains stable and resilient in the face of current and emerging risks. This emphasises the need to have in place a robust financial stability framework that will allow for the management and mitigation of crises by undertaking the necessary legislative and regulatory reforms, in line with international best practices and standards. To enhance the country's financial stability framework, a number of key deliverables, highlighted in Figure 6, have been identified and categorised into four main focus areas, which will be undertaken in the short to medium term.

Figure 6: Key deliverables for the short to medium term



The enactment of the Financial Stability Act, 2023, was the stepping stone towards enhancing the domestic financial stability framework, by providing a clear mandate and formalising the institutional arrangements. The next step is to develop a clear strategy for promoting financial stability by underlining the main priority areas for the short to medium term and the manner it will be implemented. The Financial Stability Strategy, will guide the work of the FSC towards fulfilling its financial stability oversight mandate.

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