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"Vision for the Financial Landscape of the Caribbean – Making it Happen"
(T&T Whitepaper on Financial Sector Reform)

Panel Discussion at the
Caribbean Actuarial Association Conference

by

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(i) **Let me start off with our vision for the financial sector of Trinidad and Tobago.**

(ii) **A quick summary of the current state of the sector.**

(iii) **The plans in train for achieving the vision.**

The Vision

According to the White Paper on Financial Sector Reform:

The vision for Trinidad and Tobago is to create a **Pan-Caribbean Financial Centre** that is globally competitive, well-diversified, responsive, and market-driven. This Financial Centre should provide the widest possible range of financial products and services to cater for the needs of international and regional business, domestic and regional, small and medium-sized enterprises, and the general public and private sector. This Centre will be supported by a **modern information technology architecture** that rapidly delivers a high quality and cost-effective menu of financial services options to its customers. Most importantly, this Pan-Caribbean **Financial Centre will be regulated by a single Regulatory Authority**.

The White Paper identifies some of the essential requirements of this envisaged Centre as:

(a) an efficient and effective payments system.

(b) a reliable and timely information system.

(c) a strong legal and prudential regulatory infrastructure that emphasizes financial soundness and stability, as well as the application of rules and a code of conduct that is consistent with international best practice.

(d) a modern information technology environment that enables delivery of cost effective services.

(e) a well-educated, skilled and flexible cadre of professionals with training in finance, economics, business, accounting, law, regulation and information technology that is internationally recognised.

That's the vision …….

What's out current situation?

A recent report by one of the international rating agencies characterised our financial system as **fairly advanced, with relatively sophisticated institutions, products and technologies,** highlighting Trinidad and Tobago's status as a regional economic power (and I might add, the regional financial centre).

Overall:

(i) **the banking system is very well capitalised** with a capital adequacy ratio of over 20 percent, way above the statutory minimum required of 8 percent;

(ii) non-performing loans for the system as a whole averaging about 3 percent is good by international standards;

(iii) bank's profitability is very healthy, (so people think too much so)

Some of the shortcomings are that:

(i) by and large, the banks are not sufficiently involved in lending to the energy sector or to small businesses; and

(ii) some people feel that weak competitive pressures are what have allowed banks to maintain profitability levels through increasing margins rather than by improving operating efficiency.

I am not sure that this is entirely correct but there is no doubt that there is an uncomfortable level of **concentration** in the banking system (indeed in the entire financial system). Specifically two of our six banks account for about sixty percent of deposits and about 90 percent of funds under management. (I would return to this issue of concentration later).

The Capital Market

The various segments of our **capital market** have evolved at markedly varied rates over the past two decades. For example, there have been considerable advances in respect of **collective investment schemes** (the mutual fund industry); we have made important strides as regards **the development of our debt markets**. However, by and large there has been limited progress in respect of our **equity markets**.

As **at the end of 2003**, there were some 60 funds with more than $20 billion under management.

Mutual funds have now become a major savings vehicle in Trinidad and Tobago. In fact, in the last two or three years, the growth in mutual funds exceeded that of bank deposits by a wide margin.

There has also been a **significant expansion in our debt markets; not for corporate debt but for public debt**. Over the last five years or so, there have been close to **200 bond issues** registered by the

Trinidad and Tobago Securities and Exchange Commission. The bulk of these (close to 90 percent) have been the local public sector; the local private sector has accounted for less than 10 percent of the bond issues listed.

In addition, over the past five years, Trinidad and Tobago has been a major source of debt financing for regional governments and corporations which have raised some US$1.1 billion through foreign currency bond placements.

As I said earlier, **the least advance has been made in the equity segment of the market.** Here, while market capitalisation has increased substantially, and the market has registered a rate of return exceeding that of mature markets (this has been the case for almost all emerging markets), **the institutional characteristics of the market, as well as the trading patterns, have changed little over the last two decades.**

Several factors have been advanced to explain the continued weaknesses and the lack of development in our local equity market. These include:

(i) the bias in the fiscal system towards debt as opposed to equity financing.

(ii) a reluctance by private companies to dilute control and to disclose sensitive information to outsiders.

(iii) an individual investor population that is risk-averse and lacks confidence in the market.

(iv) an archaic share settlement system, based on the physical delivery of share certificates, which involves a protracted time period for the transfer of ownership.

(v) a lack of confidence in the mechanism of share price determination of the Stock Exchange. This would seem to be perhaps the major problem.

What are we doing?

First, as regards **the banking** system, we are working aggressively on a number of amendments to the FIA to deal with obvious gaps in the existing legislation.

The main amendments will give the Central Bank authority to:

- supervise and regulate holding companies;
- institute cross border supervision and the sharing of information with other regulatory authorities;
- introduce measures to limit or restrict intra-group exposures;
- approve maximum shareholding in a licensee;
- approve mergers and acquisitions if the merged institution exceeds a certain market share threshold;
- increase the enforcement powers of the Central Bank.

Many regional jurisdictions already have these provisions in their legislation.

We are also in the process of **enhancing the regulatory framework** for the capital market through amendments to existing legislation. The new legislation, which is expected to be presented to Parliament before the end of the year or early next year will, inter alia:

(i) establish an effective takeover code;

(ii) introduce international standards for disclosure (the plan will be to move to quarterly reporting for listed companies instead of semi-annual reporting as currently exists). **Incidentally both Jamaica and Barbados already have quarterly reporting**;

(iii) improve corporate governance; and

(iv) increase taxes on off-the-floor transactions.

The new legislation would also give the SEC additional and enhanced powers to prevent unsafe and unsound practices in the conduct of the securities market, to conduct routine on-site inspection and off-site monitoring of securities companies and investment businesses, to supervise collective investment schemes and those acting as arrangers and sales agents, and to detect, investigate and enforce the provisions of the SIA in respect of market abuses in the shares of public companies.

The regionalisation of the stock exchange has been advanced as one way of addressing the smallness and illiquidity of national stock exchanges. This could present major challenges because of differences in legal systems, foreign exchange restrictions in some countries, and differences in accounting and reporting standards. In the meanwhile, efforts need to be made to increase the number of cross-listings (we currently have three such) and to integrate the individual country trading platforms.

Risk assessment, like liquidity, is a critical element of capital market development. The **Caribbean Regional Credit Rating Agency** has been established. This would address an important shortcoming and provide a common benchmark to evaluate the credit quality of issuers.

The Real Time Gross Settlement System (RTGS)

The RTGS has been introduced. The system will provide for faster, safer and more efficient settlement of large transactions and this would improve the efficiency of the financial system. The RTGS will also provide for more efficient and timely settlement of securities transactions, [thus] amending the cumbersome settlement arrangements, which was one factor that constrained the development of the equity market.

Of course, the Trinidad and Tobago Central Depository (TTCD) was another positive step towards the improvement in the equity market. We are now in the process of linking the TTCD and RTGS.

The Automated Clearing House for smaller transactions (the ACH) is to be introduced by mid-2005.

A most significant initiative in our efforts to strengthen our financial infrastructure is the move by the Central Bank to establish the Professional Advisory Committee. As some of you may know this Committee, comprising practitioners in the fields of Accounting, Banking, Law, Securities and Actuarial Science, has among its objectives:

(i) to help raise standards and promote best practices in the respective industries;

(ii) to contribute to improving the quality and scope of financial reporting and disclosure;

(iii) to provide input to the Bank on proposed industry guidelines and legislation

Last year, the Central Bank, in collaboration with the commercial banks, established an Office of a Banking Ombudsman to serve as a mediator between banks and their customers and to provide fair and impartial resolution of banking disputes.

The office has been very successful, not so much because of the number of cases it has resolved but because it has encouraged banks to set up and to take more seriously their own dispute-resolution mechanisms.

The Central Bank and the Executive of ATTIC have agreed to work toward extending the current Banking Services Ombudsman into a Financial Services Ombudsman that would deal with both banking and insurance services. A working committee comprising representatives of the Office of the Financial Institutions of the Central Bank and ATTIC has been formed to work out the details of this Ombudsman scheme with a view to possible implementation during the first quarter of 2005.

A few words on the Insurance industry and the Credit Unions

I mentioned concentration with respect to the banking industry. Let me give you some more data relating to the insurance industry, and keep in mind the very close linkage between the banking and insurance sectors in Trinidad and Tobago.

As regards **life insurance business**, three companies account for 60 percent of the business.

As regards **group pension and annuity**, one company controls 88 percent of the business.

On the **general insurance** side as measured by gross premiums, three companies control 54 percent of the market.

The point is that the level of concentration in these two industries – banking and insurance – raises the contagion risks and increases the vulnerability of the financial system. This was one factor in the Jamaican financial crisis of the late 1990's.

As you know, in May, the Central Bank assumed regulatory responsibility for the insurance industry and private pension funds. This was only a first step. Currently we are trying to get the entire insurance industry to improve their operations from a prudential and from a good market-conduct stand-point. We are also trying to get the industry accustomed to more organised supervision, including on-site supervision.

The majority of the companies seek to be in compliance with the current legislation. Unfortunately, there are some that do not meet even these minimum requirements.

Concurrently, the Bank is working to upgrade the 1980 Insurance Act to bring it more in line with the requirements. The revisions will focus on:

- increased minimum capital requirements;
- modern standards of corporate governance;
- new standards of market conduct;
- enhanced powers for the Supervisor;
- reformed investment guidelines.

The Credit Union

The credit union movement mobilises a sizable amount of resources – on our estimate, close to $3 billion. They are an important part of the financial system. There are apparently 130 operating credit unions with assets ranging from $200 million to $750 million account for 50 percent of total credit union assets. We also have a new paradigm whereby the larger credit unions are involved in many products and services associated with the commercial banks.

Of course, as you know, the expansion of the credit union sector over the last several years has taken place in the absence of an appropriate legislative framework. This has resulted in some credit unions operating contrary to the minimum prudential requirement – for example, with low capital adequacy, with a high ratio of non-performing loans. There have been reports in the newspapers of credit unions not being able to fully meet their obligation.

There is no doubt that the sheer volume of resources being intermediated by the credit unions as well as the rapid changes taking place in the more aggressive segments of the sector underscore the critical need for stricter regulation **to protect the funds of their members and more generally to help in maintaining the soundness of the financial system.**

As you know, the Minister of Finance has proposed a legislative amendment (to bring the largest credit unions for those doing banking business) under the regulatory ambit of the Central Bank.

The evolution of Trinidad and Tobago as a major financial centre has already begun to put pressure on a limited pool of skilled manpower with advanced training in investments, regulation, finance and information technology. The immediate effect has been the bidding up of the price of these labour categories, as firms try to position themselves strategically. Secondary and tertiary educational institutions now face the challenge of significantly increasing the relevant course offerings to help meet the increase in demand.