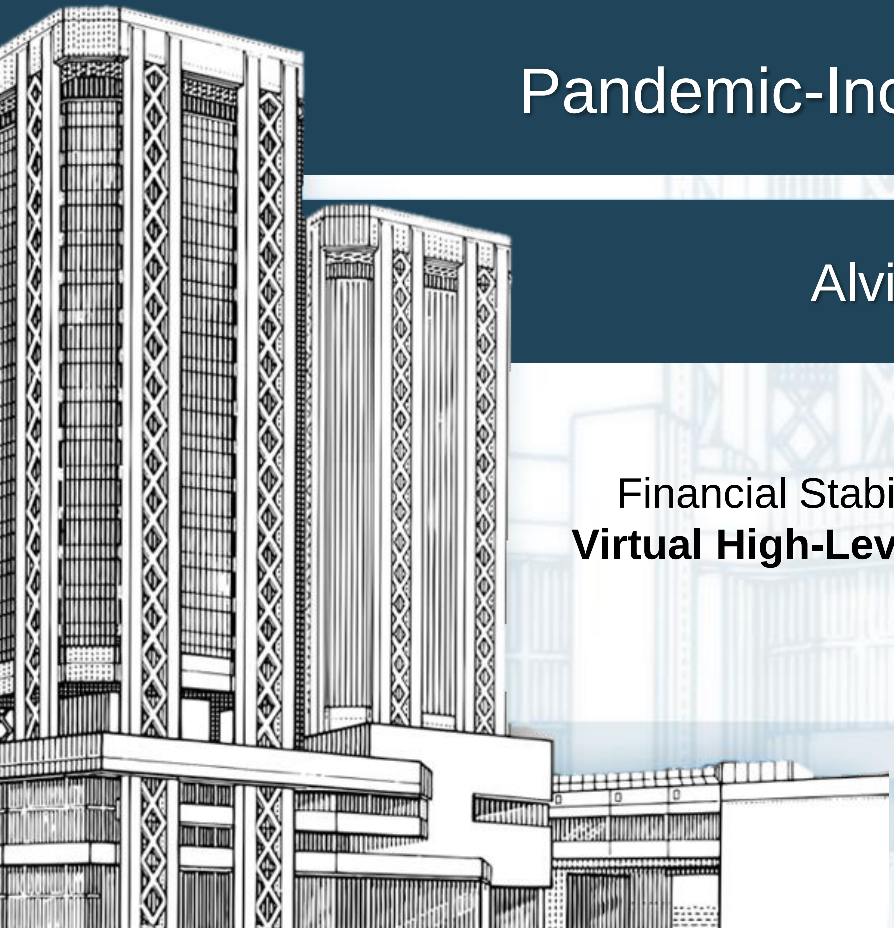
This is NOT a Drill!:

Pandemic-Induced Stresses to Trinidad & Tobago's Financial System



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Financial Stability Institute-Basel Committee on Banking Supervision-Central Bank of The Bahamas
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This is NOT a Drill: Pandemic-Induced Stresses to Trinidad & Tobago's Financial System*

Key Points

1. Trinidad & Tobago's financial system entered the pandemic in a strong and stable position.
2. Stress tests based on a sudden global pandemic would likely have given fairly stark results.
3. Latest data show that the financial system has been weathering the storm.
4. The initially slow moving nature of the virus, as well as behavioural and policy responses, helped to mute the pandemic's impact so far.
5. Supervisory measures have been broadly in line with international actions.
6. The core of the Central Bank's supervisory changes involved two phases of a forbearance regime.
7. Some planned elements of the Basel II/III framework were also postponed.
8. The Central Bank employs proportionality in conducting supervision and regulation.
9. A relatively substantial amount of loans were granted deferrals at the initiation of the program.
10. Notwithstanding the current stability, our regulators remain in high alert mode.
11. Priorities over the next 5 years encompass the potentially lasting impact of the pandemic.
12. International standards provide a good benchmark for small jurisdictions and must be tailored to country circumstances and growing cross-border activities.

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1. Trinidad & Tobago's financial system entered the pandemic in a strong and stable position.

- Financial soundness indicators pointed to a **healthy financial sector** prior to the onset of the COVID-19 pandemic.

- Banks at the end of 2019 exhibited:
  - **High capitalisation** — the average ratio of capital to risk-adjusted assets was 23.6%, well in excess of the regulatory minimum of 8%[1].
  - **Strong asset quality** — the share of non-performing loans to total loans was just 3.1%.
  - **Good profitability** — return on equity averaged 24.3%.
  - **Adequate liquidity** — the ratio of liquid assets to total assets was 21.5%.

- Insurance companies and other financial institutions also exhibited **stability and dynamism** brought about by technological changes and a wave of mergers and acquisitions domestically and across the Caribbean region.

- Some of the key financial sector vulnerabilities included:
  - Heavy **sovereign debt** exposure.
  - Growing **household debt.**
  - A sluggish **macroeconomic situation** at the time.
  - The longer-term impact of environmental developments and **climate change.**

[1] The regulatory minimum capital adequacy ratio was increased to 10% following the implementation of Basel II/III rules in May 2020.

2. Stress tests based on a sudden global pandemic would likely have given fairly stark results.

CBTT Stress Testing Results: Commercial Banking System[1]

SINGLE FACTOR TESTS		Change from Pre-shock Adjusted Capital Adequacy Ratio (%)
Interest Rate Risk	Interest Rate ↑ 700 basis points	**-11.5**
	Interest Rate ↓ 100 basis points	**1.5**
Foreign Exchange Risk	TT Dollar depreciates 40 per cent	**1.1**
Credit Risk	Credit Portfolio worsens on account of 20 per cent decline in GDP	**-2.1**
Credit Risk - Property Prices	Property Prices ↓ 30 per cent	**-2.2**
SCENARIO TESTS		**Change from Pre-shock Adjusted Capital Adequacy Ratio (%)**
Energy Price Shock	Price ↓ 50 per cent - No Policy Response	**-9.7**
	Price ↓ 50 per cent - Policy Response	**0.5**
Local Disaster Scenario		**-1.6**
Regional Disaster Scenario		**-1.3**
LIQUDITY		**Days Until Illiquid**
Liquidity Risk	Bank run on deposits	**64**

[1] Results based on data as at December 2019.

Source: Central Bank of Trinidad & Tobago.

- The Central Bank of Trinidad & Tobago conducts stress tests of the commercial banks.
- Single factor stress tests incorporate, inter alia, interest, exchange rate, credit and liquidity risks.
- Some of the scenario tests conducted in 2019 included energy price drops and local and regional disasters.
- The December 2019 tests showed that the commercial banking system as a whole was resilient to some significant shocks, although results varied across institutions.
- While a sudden pandemic shock was not explicitly modelled, the demonstrated impact on the overall economy (8.9% GDP contraction), the labor market and business activity would likely have resulted in:
  - major credit weakness;
  - feeding into capital deterioration;
  - financial losses; and
  - potential liquidity problems.
- The fears that the global health crisis would quickly morph into economic and financial crises preoccupied policy makers around the world.

3. Latest data show that the financial system has been weathering the storm.

- The capital adequacy ratio (CAR) of banks declined from 23.6% to 18.8%, still well above the regulatory minimum of 10%.
- Most of this decline in the CAR (300 basis points) actually reflected tighter standards for assessing risk following adoption of the Basel standards in May 2020.
- Despite difficulties faced by borrowers in servicing their loans, the ratio of non-performing to total loans (NPL) rose from 3.1% to just 3.4% in March 2021.
- Deferrals and adjustment to regulatory treatments helped to limit the measured decline in NPLs.
- Banks were generally quite conservative with respect to provisioning practices, resulting in a marked increase in specific provisions for impaired loans.
- At the same time, bank profits have taken a hit.
- Liquidity remained very comfortable.

Banking System Financial Soundness Indicators (%)

	Dec-18	Dec-19	Mar-20	Jun-20	Sep-20	Dec-20	Mar-21
Regulatory Capital to Risk-Weighted Assets (CAR)[1]	23.3	23.6	23.9	24.2	20.1	19.6	18.8
Non-Performing Loan (NPL) Ratio	3.1	3.1	3.0	3.5	3.4	3.4	3.4
Specific Provisions-to-Impaired Loans	53.4	48.8	64.7	62.0	67.2	71.2	72.9
Return on Equity	20.2	24.3	13.4	10.2	10.2	12.4	13.8
Liquid Assets-to-Total Assets	19.0	21.5	19.4	21.1	23.5	22.5	20.4

Source: Central Bank of Trinidad & Tobago.

4. The initially slow moving nature of the virus, as well as behavioural and policy responses, helped to mute the pandemic's impact so far.

- From its origin in Wuhan, by the time the novel coronavirus reached Trinidad & Tobago, the dangers were well understood.
- By the second quarter of 2020, government and financial institutions around the world had already started to adjust operations.
- Historically, financial institutions in Trinidad & Tobago are quite conservative, and started to prepare relatively early.
- The Government put in place a number of containment measures to curb the spread of the virus, and support measures to deal with the economic fallout.
- On the monetary front, the Central Bank took the unprecedented steps to combine a sizeable drop in the repo rate with a lowering of the reserve requirement to boost financial system liquidity.
- Through its supervisory arm, the Central Bank temporarily eased the regulatory treatment on past due and restructured loans to facilitate loan deferrals and stave off major credit delinquencies.
- At the same time, businesses and individuals also made significant adjustments, including restraining their demand for credit given their lower income positions and the uncertain outlook.

5. Supervisory measures have been broadly in line with international actions.

Summary of Regulatory and Supervisory Responses in the Caribbean

	REGULATORY AND SUPERVISORY RESPONSE MEASURES						
	Asset classification/ valuation and provisioning	Modification to the capital framework[1]	Central Banks – measures to maintain or increase system liquidity	Changes to supervisory process/ approach[2]	Prioritisation of supervisory work (monitoring/ off-site reviews)	Lending (moratoria)	Changes to and/or reinforcement of other prudential requirements[3]
Aruba		X	X		X	X	XXX
Bahamas, The	X			X	X	X	X
Barbados	X	X	X	X	X	X	X
Belize	X	X	X	X	X	X	X
Bermuda				X	X		
Cayman Islands				X	X		X
Curaçao & Sint Maarten				X	X		X
ECCU-ECCB	X		X	X	X	X	XX
Guyana	X				X	X	X
Jamaica	X		X		X	X	XX
Suriname		X	X	X	X	X	
Trinidad & Tobago	X		X	X	X	X	XXX
Turks & Caicos				X	X		XX

[1] Including regulatory minimum, risk weights, exposure limits, use of buffers
[2] Including requirement for stress testing, monitoring of capital and liquidity positions, additional information on loan portfolio
[3] Including suspension of Dividends and Regulatory Filing, AML/CFT, BCP, Cybersecurity

Source: Lewars, Ralph, Jaime Ponce and Antonio Pancorbo. 2021. "Unwinding COVID-19 Policy Interventions for Banking Systems." Presentation at CARTAC Webinar: Unwinding COVID-19 Policy Interventions for Banking Systems, May 28, 2021.

- The pandemic prompted financial regulators around the world to take measures to cater for the impact of the virus on borrowers and financial institutions.
- Actions generally center around addressing borrower support, bank capital and liquidity.
- The approach in the Caribbean is in line with international efforts, with time frames depending on country circumstances and experience.
- Trinidad & Tobago's regulatory/supervisory actions were fairly wide ranging — including on asset quality, moratoria, detailed reporting requirements and tracking credit quality developments.
- Unlike some countries, Trinidad & Tobago did not restrict dividend distributions nor adjust regulatory capital or liquidity buffers.
- Trinidad & Tobago did however delay a previously announced schedule for additional capital and liquidity requirements.

6. The core of the Central Bank’s supervisory changes involved two phases of a forbearance regime.

- In 2020 an initial 3-month deferral program was twice extended to cover 10 months altogether.
- In 2021 a deferral plan was reintroduced for a 5 month period.
- The main difference between the 2020 and 2021 arrangements was that the latter specified that borrowers had to ‘opt in’ to the program.

		MORATORIUM ON THE REGULATORY TREATMENT OF PAYMENT DEFERRALS OR RESTRUCTURED LOANS DUE TO COVID-19 MEASURES			
		PHASE 1			PHASE 2
Date Applicable		**Mar 1, 2020 – Dec 31, 2020**			**May 1, 2021 – Sep 30, 2021**
		Initial expiry date of May 30, 2020	**Expiry date extended to Aug 31, 2020**	**Expiry date extended to Dec 31, 2020**	
Coverage		Payment deferrals or rate reductions apply **only to performing loans and loans past due up to 89 days** as at March 1, 2020 (REGIME 1) or as at May 1, 2021 (REGIME 2).			
Treatment		Banks can defer loan payments on ‘Opt in’ or ‘Opt out’ approaches			Only ‘Opt in’ treatment allowed.
Reporting	**Performing Credit Facilities**	Borrowers who were current prior to accepting "skipped payment" provision should not be reported as past due. The loans of borrowers who accept a rate reduction should not be reported as "Restructuring or Rescheduled".			
	Past Due Credit Facilities (1-89 days)	Where "skipped payment" arrangements are applied on credit facilities that were past due, the delinquency status of the loan should be adjusted back to the status that existed at the date of the borrower becoming affected for the duration of the deferral period.			
	Special Reporting	A Special Report (DPC-19) was introduced to collect data on credit facilities of borrowers granted deferrals, rate reductions and waivers of penalty charges and late payment fees. Reports to be submitted monthly within 30 business days.			
	Stress Testing	NA		Licensees to submit results of quarterly stress tests and scenario analyses that consider impact of pandemic on liquidity and solvency. Board-approved action/recovery plan to be submitted where results are adverse.	
Restructured Loans		NA			Financial institutions may restructure loans with high probability of fulfilling revised payment terms and conditions.
Disclosures		Financial institutions to provide borrowers with accurate disclosures when offering payment deferrals and/or rate reductions. The customer should have no liability to pay any charge or fee associated with the granting of the “skipped payment” or deferral arrangement.			

Source: Central Bank of Trinidad & Tobago.

7. Some planned elements of the Basel II/III framework were also postponed.

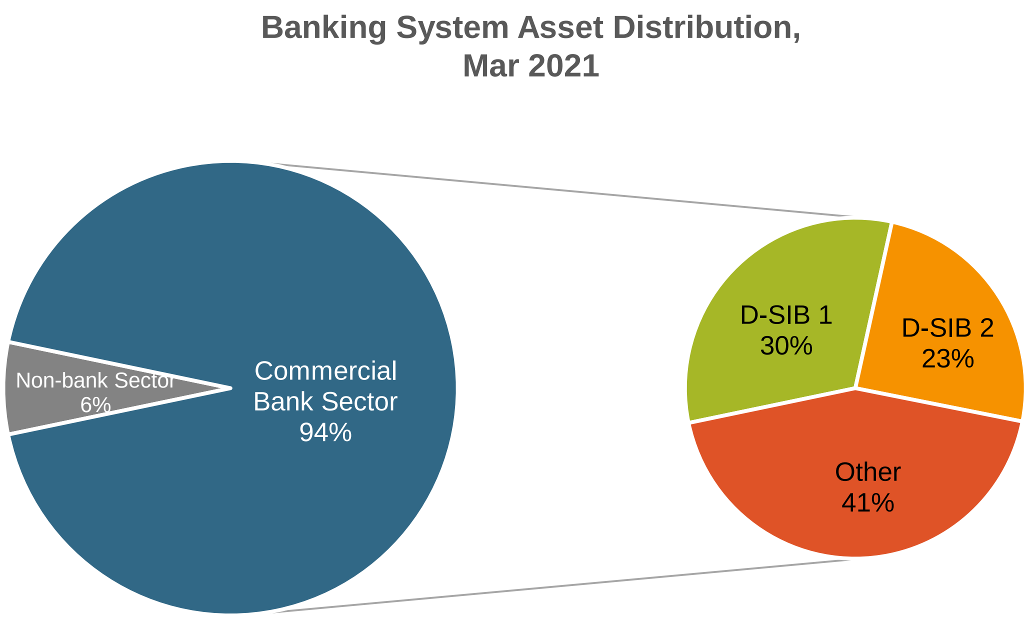
PHASE 1: *Completed May 2020*	**PHASE 2** *Implementation delayed due to potential impact of COVID-19*					
Financial Institutions (Capital Adequacy Regulations), 2020	~~Jan 2021~~ **Jan 2022**	~~Sept 2020~~ **March 2022**	~~Sept 2020~~ **March 2022**	~~Sept 2020~~ **March 2022**	~~Dec 2020~~ **March 2023**	~~Jan 2023~~ **Dec 2023**
Pillar 1 - Minimum Capital Requirement *(10% CAR, 6% Tier 1 AND 4.5% CET1 ratios)*	Supervisory Review and Evaluation Process	Leverage Ratio *(3.0%)*	Capital Conservation Buffer *(2.5%)*	D-SIB Capital Add-On *(1.0% – 2.5%)*	Liquidity Coverage Ratio *(100% [HQLA: total net cash outflows)*	Market Discipline/ Disclosure *(disclosure of capital, risk etc.)*

Source: Central Bank of Trinidad & Tobago.

- The Central Bank decided to defer the implementation of Phase 2 of the Basel II/III project implementation plan on account of the potential impact of COVID-19 on institutions.
- Considerations included:
  - potential capital dissolution — not wanting to impose additional capital requirements on top of the consequences COVID-19 may already have had on bank capital.
  - increased operational burden to meet the new Phase 2 requirements — adding to the operational burden already faced by institutions due to COVID-19.
- These considerations remain relevant so the timelines are being kept under constant review.

8. The Central Bank employs proportionality in conducting supervision and regulation.

Trinidad and Tobago has 8 commercial banks, 2 of which are considered systemically important (D-SIBs) and account for over half of banks' assets.



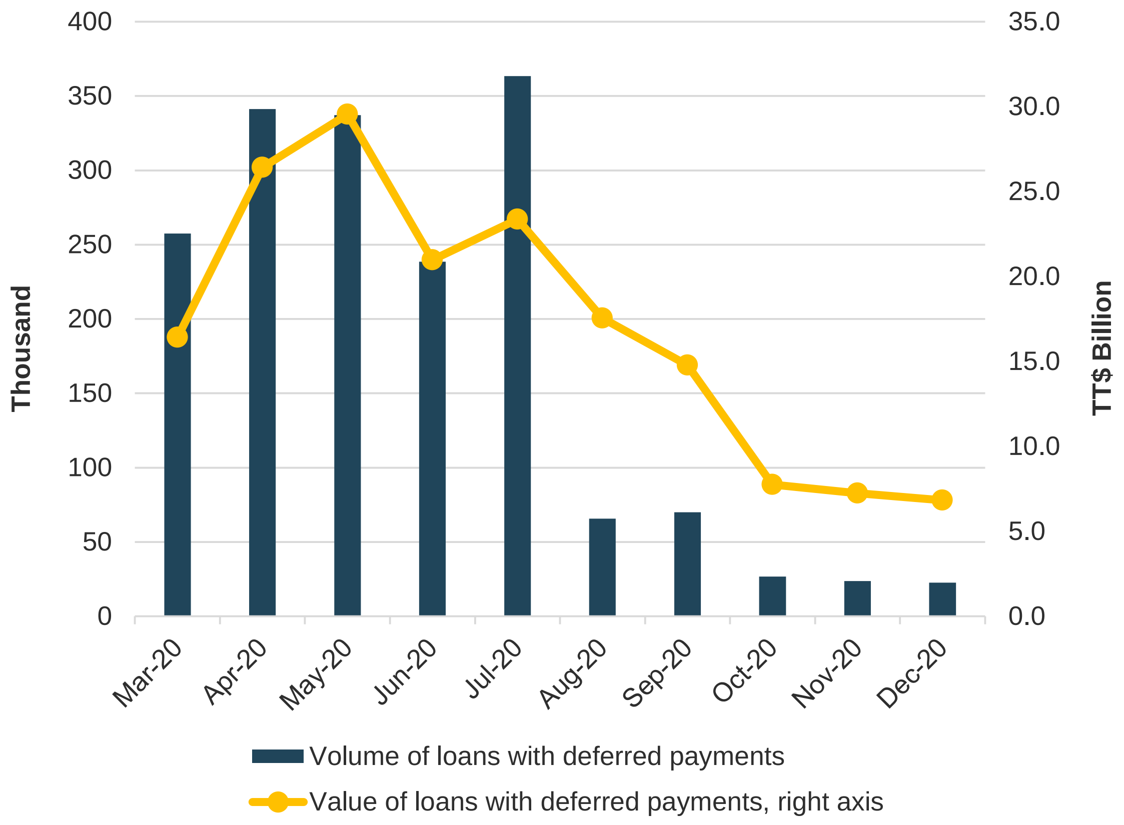
Source: Central Bank of Trinidad & Tobago.

- The Central Bank employs proportionality in supervision as well as regulation, taking into account the size and systemic reach of financial institutions.
- This essentially risk-based approach helps to keep focus on priorities for financial stability.
- This is especially important in determining how we build, train and channel our technical capacity and human resources to deal with the growing complexity of financial institutions and products.
- Regarding Basel II standards, while we implemented the Standardised Approach to Pillar 1 from May 2020, smaller banks have simpler reporting requirements.
- Proportionality is also applied to the application and reporting mandates related to the Internal Capital Adequacy Assessment Process (ICAAP).

9. A relatively substantial amount of loans were granted deferrals at the initiation of the program.

- At the start of the deferral program, over one third of participating commercial banks' loans were deferred.
- In value terms this was equivalent to over TT$16 billion (11% of GDP).
- The value of deferred loans peaked in May 2020, declining thereafter to around TT$7 billion in December, with a growing concentration on business, as opposed to individual loans.
- Some banks initially deferred most loans automatically, unless clients specifically 'opted out' of the deferral; this helped to boost the number of loans deferred.
- As the program was extended in 2020, more banks required clients to 'opt in' to the deferral program.
- The Central Bank established that the May-September 2021 deferral program must be on an 'opt in' basis and not automatic.
- Other things being equal, this is likely to result in a lower amount and value of loans being deferred in 2021 compared to the peaks in 2020.

Commercial Banking System: Total Loans with Deferred Payments, Mar20 - Dec20



Source: Central Bank of Trinidad & Tobago.

10. Notwithstanding the current stability, our regulators remain in high alert mode.

- The macroeconomic situation remains uncertain in light of lockdown measures in the context of a State of Emergency, a recent surge in virus infections and difficulties experienced in sourcing vaccines from suppliers.
- In the short run, borrowers may have increasing difficulties in servicing their loans. Some businesses may not re-open, and it is likely that there may be some mergers and acquisitions in the business sector – these sometimes come with debt restructuring and/or write-offs.
- There are also risks to the banks' balance sheets and income statements in light of a potential fall in demand for credit from quality borrowers in the local market in the short to medium term.
- How long this situation persists depends on how early the virus is tamed and how fast incomes can recover.
- As a result, monitoring credit quality remains paramount and the Central Bank has intensified efforts in this area.
- In its monetary policy, the Central Bank aims to ensure that the flow of credit to the real economy is sustained during the period of unwinding of support measures.
- At the same time, the Bank recognises that overall strategies by the fiscal, monetary and supervisory authorities must be holistic, avert moral hazard problems and must be increasingly targeted.
- In addition to the foregoing, there is potential for cash strapped businesses and individuals to turn to the informal sector to access financing, thereby deepening the country's exposure to money laundering / terrorist financing activity and organised crime.

11. Priorities over the next 5 years encompass the potentially lasting impact of the pandemic.

**Financial Stability Theme in
Central Bank of Trinidad & Tobago
2021/22—2025/26 Strategic Plan**

Objectives:

- Ensure a well functioning and stable financial system.
- Prepare for an evolving financial landscape in collaboration with other regulators.
- Develop an efficient payments system.

Projects:

- Reinforce banking sector supervision.
- Build on the new legislation in advancing risk-based insurance regulation.
- Determine the scope for reform to pension schemes and other areas currently supervised by the Central Bank.
- Explore the role of the Central Bank in areas currently not under our supervision.
- Advance financial sector crisis management and resolution plans.
- Modernise Trinidad & Tobago’s payments system.
- Expand the Central Bank’s market conduct oversight.

12. International standards provide a good benchmark for small jurisdictions and must be tailored to country circumstances and growing cross-border activities.

- Our assessment in Trinidad & Tobago is that international standards on banking supervision have been quite helpful.

- The Basel Core Principles for Banking Supervision provide a good checklist to gauge our progress over time and our standing relative to other jurisdictions.

- The proportionality principles embodied in the international approach also give due recognition to risk; so far our implementation of the Basel framework is working well, taking into account these principles.

- Our recent experience with the Financial Stability Assessment Program (FSAP) in 2020 has been excellent, in working with the IMF/World Bank on the practical employment of international standards to our circumstances.

- We recognize that in Trinidad & Tobago, and likely in many other small jurisdictions, we need to progressively shore up our technical capacity; the FSAP and similar exercises point to the invaluable benefit of dedicated on-site attachments and staff exchanges, to complement the many conferences, seminars and literature offered by the international standards setting bodies.

- Finally, we recommend that international standards take greater account of regional coordination issues: in the Caribbean, as in other areas, there is growing cross-border activity and supervisors need to rely much more on each other to assure regional financial stability.

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