

Current Financial Stability Issues in Trinidad and Tobago



CENTRAL BANK OF
TRINIDAD & TOBAGO

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Current Financial Stability Issues in Trinidad & Tobago*

Key Points

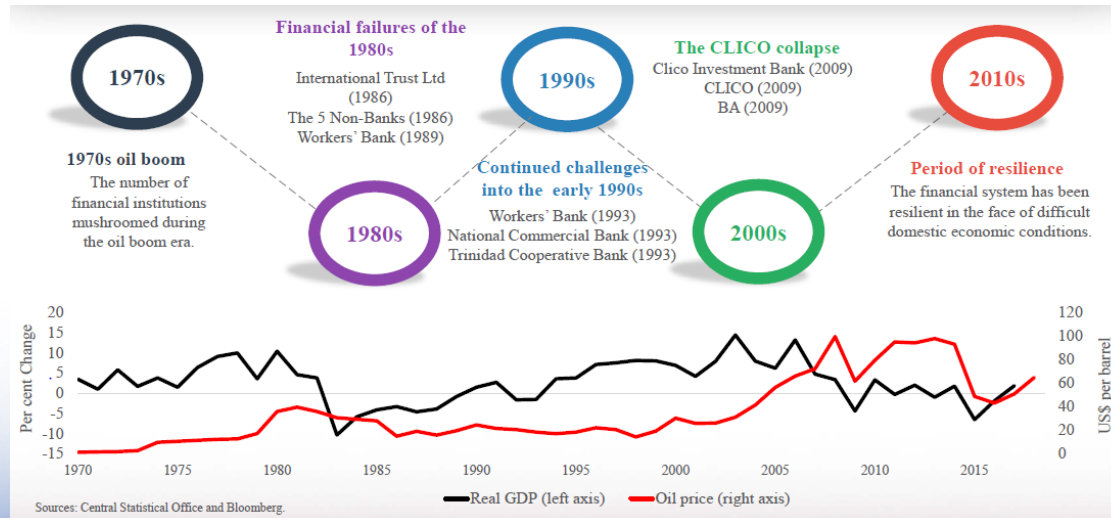
1. As in many other countries, financial supervision in Trinidad and Tobago is currently in high alert mode given the Covid-19 pandemic shock.
2. Trinidad and Tobago's financial system is sound, well capitalized and healthy but there are some vulnerabilities.
3. These include rising household debt, sovereign exposure, and an uncertain macroeconomic outlook.
4. Legislative, supervisory and regulatory reforms need to be stepped up to deal with existing challenges, growing digitization and a more integrated world.
5. The recently completed IMF/World Bank Financial Sector Assessment Program (FSAP) cited the strength and resilience of the local financial sector.
6. The FSAP also assessed the large stresses that the pandemic could potentially put on financial institutions.
7. The Assessment called for urgently updating legislation, introducing more risk-based supervision, and broadening supervisory oversight on institutions such as credit unions.
8. Longer term recommendations included integrating climate change and green finance considerations into developing the financial sector.
9. Consistent with our Strategic Plan, the Central Bank has a range of activities planned to bolster supervision in all spheres, particularly on credit quality in the short run.
10. This will require intense collaboration with national authorities, other domestic and foreign regulators and financial entities.

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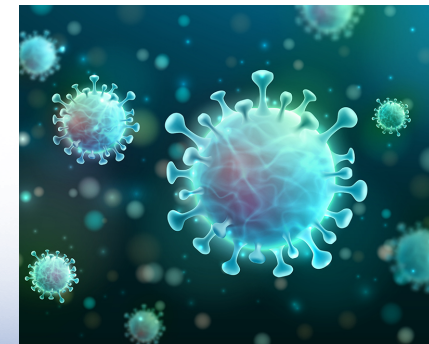


Financial supervision in Trinidad & Tobago is currently in high alert mode

- The international experience on the coronavirus is clear—*“The deep recession and the serious income losses for families and firms may provoke significant challenges for financial systems. Unlike recent financial or balance of payments’ crises, this may be more of a slow-moving event in which credit risks take center stage. Good policies will be critical to navigate the coming months.”* (Powell and Rojas-Suarez, CGB-IDB Report, 2020)
- In Trinidad & Tobago, past episodes of financial sector problems have been associated with macroeconomic difficulties, so we need to shore up our defenses and be prepared on the policy front.



- If prolonged, the pandemic could limit borrowers' capacity to repay, and weaken financial institutions' asset quality.





The domestic financial sector is fundamentally healthy and sound

	Jun-18	Jun-19	Jun-20
BANKING SECTOR (per cent)			
Regulatory Capital-to-Risk-Weighted Assets	24.5	23.9	24.2
Non-Performing Loan Ratio	3.4	3.4	3.5
Return on Equity	18.9	23.9	10.1
Liquid Assets-to-Total Assets	19.9	20.3	21.1
LIFE INSURANCE SECTOR (per cent)			
Investment Yield	4.8	4.8	5.0
Return on Equity	14.0	12.3	14.9
NON-LIFE INSURANCE SECTOR (per cent)			
Loss Ratio	53.4	46.3	42.8
Investment Income / Net Premium	7.0	6.6	6.8
OCCUPATIONAL PENSION PLANS (TT\$Bn)			
Fund Assets	52.4	53.3	53.3

- Financial stability indicators show that in general, banks are well capitalized, profitable, have good liquidity and credit quality is still strong.
- The performance of the insurance sector is also commendable.
- At the same time, credit growth is sluggish and has not yet responded to the recent significant monetary policy actions in March 2020 (drops in the reserve requirement and repo rate).
- The weak credit response is likely due to both demand (individuals and businesses reluctant to borrow more) and supply (banks' concern regarding maintaining credit quality) factors.



...but there are some vulnerabilities, and reforms are necessary

The *Financial Stability Report 2019* highlighted some financial sector **vulnerabilities** that need to be kept in mind, including:—

- **Rising household debt:** which grew by about 10% of GDP since 2010.
- **Sovereign credit exposures:** about one third of financial system assets are public sector instruments.
- **The demands of digitization:** as the world embraces more electronic transactions, cyber risks mount.
- **Growing interconnectedness:** TT's financial institutions are closely involved or part of other regional/international entities.
- **Susceptibility to shocks:** notably energy prices, natural disasters, global pandemic and climate change.

On the **policy front** therefore we need to:-

- Advance the required **legislation**, updating as needed to deal with modern world challenges.
- Continue to develop a more **risk-based approach to supervision**.
- Modernize and extend **safe electronic processes** to all communities.
- Develop closer relationships among **domestic and external regulators**.
- Strengthen the **capacity to weather the inevitable shocks** that will occur over time.



The recent Financial Sector Assessment Program (FSAP) will help shape the Central Bank's supervision plans

- Our *Strategic Plan, Blueprint for Continued Financial Stability* and *Financial Stability Reports* set out our plans to bolster supervision.
- High powered IMF/World Bank experts conducted the Financial Sector Assessment Program (FSAP) in 2019/20.

- We appreciate the rigorous, professional and independent FSAP analyses and are working on practical implementation of agreed recommendations.





The 2020 FSAP cited the strength and resilience of the domestic financial sector

The 2020 exercise built on earlier assessments in 2005 and 2010 which had found that:

- Credit, market and liquidity risks were low in the banking sector.
- Short-term fragilities were evident in the insurance sector.
- Supervisory, regulatory and legislative deficiencies needed to be addressed in order to mitigate financial risk.

Most of the latest analysis was conducted prior to the pandemic, with the following overall evaluation:

- The financial sector successfully navigated the economic slowdown of 2016-2018.
- The banking system was well capitalized and liquid, while the general insurance sector recovered from the challenges posed by climate-related events in the region.
- Trinidad and Tobago made considerable progress in strengthening its AML/CFT framework.
- Financial sector legislation and regulation have not generally kept pace with international best practice.

The key risks assessed included:

- Rise in household debt; sovereign concentrations in the banking sector; regional interconnectedness; environmental and climate risks.



Stress tests showed the potential impact of Covid-19 on the financial sector

Stress tests assessed the sensitivity of financial institutions' portfolios to extreme but plausible shocks.

Commercial Banks

Pre-COVID-19 Adverse Scenario (Combined shock including lower energy prices and regional contagion)

- No bank would breach the regulatory minimum capital requirement.
- Liquidity levels are adequate, but some tightness in foreign currency liquidity.

COVID-19 Central Scenario (Economic recovery in 2021)

- All banks remain resilient to shocks employed, but capital adequacy ratios take a discernible hit.

COVID-19 Downside Scenario (Prolonged economic contraction)

- A few banks would experience solvency challenges if tepid economic conditions persist over the medium-term.

Insurance Companies

- Insurers are vulnerable to a series of consecutive and severe natural disasters, with almost one-third of regulatory capital being consumed.





Key recommendations addressed the legislative and supervisory framework

- The **independence, governance and resources of supervisors**, including assigning powers to issue regulations, need to be addressed.
- The introduction of Basel II/III regulations will bolster the **banking sector's resilience** while market discipline can be improved by Pillar III disclosures.
- The upcoming implementation of **new insurance legislation** is much needed and will strengthen the supervisory regime.
- Increasing the span of consolidated supervision of financial conglomerates to ensure that all the material financial entities in the group are assessed.
- The legislative framework for the regulation and supervision of **credit unions** should be buttressed given the important role of these institutions for a large number of persons.



Broader recommendations involved strategies to deal with underlying financial developments and climate risk

- Articulation of a comprehensive **national financial development strategy** is useful to keep pace with global tectonic shifts.
- The **role of the state in financial intermediation**, particularly with respect to development financing, should be fleshed out.
- Measures to promote the use of **digital financial services** should be advanced to aid in efficient, safe and widely accessible electronic financial transactions.
- Conduct an **environmental risk assessment** to raise awareness of the impact of climate change and environmental risks on the financial sector.





Building on our 2019 *Blueprint*, the Central Bank's plans start with commercial bank supervision

1. Monitoring credit and liquidity risk

- The current climate calls for intensifying the review of banks' credit risk. Such reviews, focusing on refinanced and debt consolidation loans, are already underway. Guidelines on Credit and Liquidity Risk are being finalized.

2. Assessing appropriate bank capital

- Appropriate capital is necessary to assure the health of banks. Higher capital requirements that take greater account of key risks in banks' operations, were introduced in May 2020.

3. Strengthening governance in commercial banks

- Updated Corporate Governance Guidelines for banks were introduced in June 2020, and supervisors will have greater interaction with commercial banks' Boards and Board Committees to assure strong governance and internal controls. These Guidelines are also applicable to other financial institutions.

4. Advancing market conduct

- Work already in train to strengthen the conduct of bank-customer relationships will continue and benefit from a survey in mid 2020 and the public education and interface role of the Office of the Financial Services Ombudsman/National Financial Literacy Program.



Insurance supervision will be grounded on the new legislation

- The new legislation will substantially strengthen the regulatory framework for the **insurance sector** including larger capital buffers and measures to bolster governance and controls. Insurance companies will be required to do their own stress tests.
- Meanwhile **pension plans** are being encouraged to considerably improve their communication with members while trustees and plan sponsors are being further guided to review and strengthen their adherence to prudential standards.
- As regards **credit unions**, the Central Bank continues to interface with the sector and the Ministry of Labour and Small Enterprise Development in sharing our perspectives on supervision. The Bank is poised to contribute to the national dialogue on an appropriate model for strengthening regulation and supervision in this area.



The new E-money policy marks the start of our drive towards digitization

Electronic money and fintech

- An **E-Money Issuer Order** was issued in August 2020 and a Fintech Steering Committee, including other agencies and regulators was established to move the process along. An 'innovation hub' and 'regulatory sandbox' will be set up shortly to facilitate approvals.

Payments System

- Trinidad and Tobago is a part of international efforts to improve cross border payments. Domestically, the Central Bank is working with other entities to develop comprehensive **payments legislation** to facilitate easy, modern and safe electronic financial transactions.

Central Bank Digital Currency (CBDC)

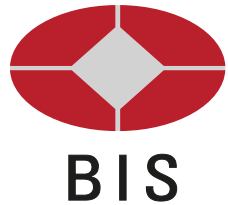
- Taking into account regional and external experiences, the Central Bank will study the feasibility of introducing a CBDC and other avenues to advance electronic financial transactions and **reduce cash usage**.



These plans require close collaboration with other financial agencies and regulators



- **Cooperation with domestic and regional regulators** and international standard-setting bodies is already well established.
- Fundamental elements of a **crisis management plan** are under discussion and will be further formalized with other agencies, drawing from the lessons from CLICO/BAT/CIB resolutions and earlier experiences.
- Overall, implementation of the Central Bank's financial stability plans also requires **ongoing communication and collaboration with our private sector financial institutions.**





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