

Marion Williams: Financial sector developments in Barbados

Address by Dr Marion Williams, Governor of the Central Bank of Barbados, at the opening ceremony of the FirstCaribbean International Bank Business Centre, Warrens, St. Michael, 29 June 2007.

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Thank you, Madam Master of Ceremonies, for your kind words of introduction.

Mr. Charles Pink; other members of the Board; members of Management and staff; specially invited guests; distinguished Ladies and Gentlemen.

Let me first offer my congratulations to FirstCaribbean on the construction of this impressive facility at Warrens. In so doing, you are confirming your long-term commitment to the development of the Barbadian economy. It has now been acknowledged that Warrens is the fastest growing urban centre in Barbados. By establishing its Head Office here, FirstCaribbean has become part of the growth and the expansion of the area and demonstrates today its confidence that this location has the potential to be a major financial hub.

Mr. Chairman, I am naturally pleased by any activity which seeks to improve the level of financial intermediation in Barbados. Financial intermediaries agglomerate capital from many small savers and allocate it to eligible users. In so doing, they also transfer, pool and reduce risk, increase liquidity and convey information, thus contributing to an environment for growth. A well-functioning financial system can make an important contribution to the growth of Gross Domestic Product.

There is no doubt that over time Barbados has enjoyed a very high standard of financial intermediation. The commercial banking sector has led the way in this regard and has so conducted itself that there is tremendous confidence in our banking system. The confidence which the public at large has reposed in the banking sector is exemplified by the continued increase in commercial bank assets. During the two decades ending in 2006, for example, commercial bank assets grew six-fold.

FirstCaribbean International Bank, whose roots in Barbados run very deep, has made a major contribution to the growth of the domestic financial sector and, by extension, to the economic well-being of Barbados. This has been demonstrated in many tangible ways over the years, including the provision of credit and foreign exchange, the issue of financial instruments and the management of assets. The construction of this facility must be seen as yet another example of the continuing effort by this organisation to be among the leaders in the financial services sector.

Over the last two decades or so in Barbados, it was investment that provided much of the impetus for the growth in Gross Domestic Product (GDP). While consumption expenditure and exports of goods and services kept pace with GDP, the growth rate of investment exceeded that of the GDP by nearly 60%. Over the same period, private building activity (which includes projects like this one) grew by 21% more than GDP.

It is projects like this one that would have facilitated the strong performance of the economy in recent years. Indeed, the construction sector is still the main driver of the economy, and expanded by 7% in 2006 and by 5.4% in the first quarter of 2007. As is the case in Barbados, the buoyancy of the construction sector generated certain spin-offs in other areas.

This initiative to rationalise your bank's operational and technical capacity is undoubtedly good for the organisation. It is widely accepted that one good measure of the development of an economy is the level of financial sophistication. As customers' income levels rise and they are exposed through the electronic media and travel to more up-market financial services, they will demand a wider range of products and better levels of service delivery. But given

the degree to which these modern products depend on accounting, internal control, technology and other services, their provision can be only as efficient as the back-office operations which support them.

Accordingly, a service-oriented bank must be constantly upgrading these back-office capabilities if it is to meet the public's demand for sophisticated products and services. A financial institution can make its reputation on its ability to deliver those services which are in the full glare of the public, but if the same institution does not allocate adequate resources to its back-office activities it will not keep that reputation for very long.

Take technology as a case in point. Modern commercial banks now use technology to improve the efficiency of distributional channels, utilise outsourcing and improve real-time transactions. As the old adage states, time is money. Since the overwhelming majority of banking transactions are time-sensitive, the efficient use of time should be the goal of both the bank and the customer. It is the state of the institution's technology which ultimately affects the bank's ability to make electronic transfers in a timely fashion. I would like to believe that customers can expect to have their accounts credited and debited more speedily as a result of this initiative and that the result will be a more satisfied customer.

I am sure that FirstCaribbean is aware that having its technological capacity in one location also has its risks and that the initiative must be accompanied by an appreciation of risk management and by contingency planning. I am therefore certain that an organisation with the reputation of FirstCaribbean, understands its important role in the intermediation process and has paid due regard to the need for preventative maintenance and the speediest possible return to normalcy after any downtime.

In recent years, the Central Bank has collaborated with commercial banks in the community in the introduction of the Real Time Gross Settlement and the Automated Clearing House systems. These initiatives from all accounts have placed the domestic financial system on the cutting-edge of payment and settlements.

However, there are other areas in which progress has been relatively slow. One of these is the establishment of a real time, on-line comprehensive database of financial statistics otherwise known as the Electronic Data Interchange. This facilitates the flow of information from the commercial banks directly into the Central Bank's database. When this is fully operational it will help to improve the formulation of monetary policy by the Central Bank and allow us to respond more quickly in a more market-based environment.

Since the start of the 21st Century, the financial sector in Barbados has experienced significant changes. These include mergers, acquisitions, the disappearance of indigenous banks as well as the introduction of new regulations and legislation, and new studies have been made particularly with respect to governance, regulatory compliance, anti-money laundering, and risk management. Now, with the full implementation of the Caricom Single Market and Economy (CSME) and the constant demands in some circles for financial liberalisation, one can expect that there will be additional changes over the next few years.

Let me now move on to talk a bit about upcoming changes in policy which will affect the operations of commercial banks.

The Central Bank of Barbados took over responsibility for exchange control in 1973 but the system predates the Bank. Exchange controls became more critical in 1975 when Barbados fixed its currency against the US dollar. The system served this country well, mainly for monitoring purposes, and helped to avoid the disastrous speculative outflows which nearly ruined some Southeast Asian countries in 1977.

During the last decade, however, there has been increasing support for the view that exchange controls can be a brake on economic development. Consequently, the Bank has been gradually liberalising its exchange controls. This view was also embraced by the originators of the CSME and commitments were given that those Caricom member countries, which still had exchange controls would remove them within a specified time frame. That

deadline is now January 2008. Accordingly, with effect from that date, Barbados is expected to honour a commitment to remove all exchange controls in respect of transactions with other CSME member countries.

Another aspect of capital account liberalisation is that it places more of the responsibility for managing the country's foreign assets in the domain of the commercial banks. It seems to me, therefore, that banks can be no less diligent in operation of a liberalised foreign exchange system than in one with some controls. This should still require banks to at least maintain adequate records of the foreign exchange transactions so as to permit monitoring.

You will realise that for a couple years now your national ID numbers are required in order to execute any foreign exchange transaction resulting in an out flow of foreign currency. The Central Bank's objective is to be able to monitor the movement of foreign exchange by individuals and companies and by type or categories and to receive this information in the Central Bank as it occurs in the commercial bank. It is planned that the system can then be manipulated to show all foreign exchange purchases by individuals cumulatively over a period of time, by company and by type of transaction. This is already possible, but currently the data has to be first input manually in the Bank. Our objective is to achieve this at the point of input of the data by the commercial bank and have it input directly into the Central Bank's database. I trust that this investment will help to facilitate that.

The conventional wisdom in academic circles is that an adequate level of financial sector development should precede capital account liberalisation. While it can be argued that commercial banks in Barbados are highly developed financial intermediaries, there are still some concerns about the non-bank financial entities. Nonetheless, now that substantially greater liberalisation is in sight I would urge all financial institutions to seek to at least increase the range and scope of domestic financial instruments. In so doing, there would also be a higher probability of attracting foreign capital.

A lack of adequate liquidity has been identified as one of the major impediments to a more vibrant financial sector. Many potential investors simply cannot find any assets to purchase. This reflects, in part, a cultural situation; where Barbadians purchase equity in a private firm or buy government securities, and tend to hold these assets for as long as possible. Some analysts believe that this conservative mind-set would change if there were an abundance of attractive issues and options coming on stream on a regular basis. In this connection, it has been suggested that the development of a secondary mortgage market could attract the attention of domestic and foreign investors. The Bank intends to proceed with implementation of the Secondary Mortgage Market as soon as the legislation is completed.

There is also a view that the market for government securities needs more dynamism. Government securities are structured to cater to the needs of both individuals and institutional investors. Since there is a zero risk associated with holding government paper, these instruments are, in the overwhelming number of cases, held to maturity even when holders experience cash flow problems. What is required are dealers in government securities who would perform the role of market makers, thereby bringing more participants and liquidity to the market.

The Central Bank is also currently considering a number of matters touching on open market operations and is developing operational modalities in this regard. We expect shortly to be able to open dialogue with the parties involved in the hope of getting buy-in from commercial banks.

It will be important in the changing environment that conditions are created to attract capital to Barbados. Commercial banks should not expect immediately to see any radical change in the way modifications to the minimum deposit rate are determined and indeed there may well continue to be some floor for its savings rate, this time as a protective mechanism rather than a monetary policy tool. The Central Bank will continue for the time being to be guided by the differential between local and foreign interest rates, but given the somewhat freer movement

of funds within CARICOM, post December 2007 more diligence will be required and more rapid market responses will be necessary.

Further exchange control liberalisation and greater flexibility in the interest rate regime are part of an overall move toward greater reliance on market forces in the financial sector. For sometime now, the Central Bank has been reducing the reserve requirements for commercial banks and the total requirement, net of the recently-introduced foreign reserve component, now stands at 17% of deposits, the lowest in three decades. It is expected that in time this requirement will be further reduced.

In terms of other developments, the legislation relating to the much-discussed Deposit Insurance Corporation (DIC) has now been proclaimed, the Board has been appointed and the Chairman Honourable Justice Leroy Inniss has called his first meeting next week, so commercial banks can expect to hear from the DIC very soon. The establishment of this entity is occurring in the context of a healthy banking system. This is unusual for the Caribbean. All other DICs were established in the context of a bank failure. This is a great beginning for our DIC. Commercial banks are also positioned to benefit from a reduction in tax on assets to assist in funding their contribution to the new Deposit Insurance Corporation. I believe that this too makes our beginning different. I expect you will, in due course, be hearing from the new Chairman who is the new spokesman for the DIC and less from me on this topic.

Ladies and Gentlemen, let me in conclusion once more applaud the decision of FirstCaribbean to construct this facility at Warrens. As Barbados strives to become a financial hub in the Caribbean region more of these kinds of initiatives will be required if we are to achieve that goal. I am confident that the Business Centre will adequately deliver the services for which it was intended and I wish that all the employees who will work here will have the most rewarding experiences.

I thank you for your attention.