Ewart S Williams: Leveraging our strength for an international financial centre

Address by Mr Ewart S Williams, Governor of the Central Bank of Trinidad and Tobago, at the International Financial Center (IFC) Symposium, Port-of-Spain, 2 April 2008.

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Early last month, I attended a conference hosted by the Institute of International Finance in Rio de Janeiro, and I sat next to a young man who was an official from the Dubai International Financial Center. After exchanging call cards, I indicated that I was from Trinidad and Tobago and was thinking about establishing an international financial center.

The young man was very pleasant but made the interesting remark that, in recent years, **many developing countries were trying to enter the field which was now becoming very crowded**. He noted that Dubai was now getting competition from other up-and-coming centers in the Middle East and Asia, and that even the industrial economies with developed financial centers now had to work aggressively to protect their traditional advantage etc.

While he did not specifically say it, the question in his eyes was, why Trinidad and Tobago? And, why would Trinidad and Tobago think that it could be an international financial center? The question prompted me to try to articulate all the things that we had going for us and to identify what, from my vantage point, would be some of the challenges that we are likely to face in the establishment of an international financial center.

Yesterday, many speakers touched on this very issue. I would go over some of the same ground but hopefully from my particular perspective.

My thesis is that we have much more going for us than we tend to realize, in which case the issue is, **how do we leverage our considerable advantages to achieve our objective**? The point was made yesterday that the reality of integrated markets and the IT revolution is reducing the need to be in a specific place to conduct financial business. However, some IFC's are thriving, suggesting that if you get a niche and if you provide value-added you could be in business.

The Minister, in her speech yesterday, and many other speakers noted, that successful international financial centers all had a number of characteristics, which could be viewed as prerequisites. First, you needed to be a vibrant economy with strong banks; you need a credible legal system, good financial and physical infrastructure and modern financial legislation. But while these are necessary, they are not sufficient conditions.

A survey of the available literature on IFCs suggest that almost all successful financial centers have used the strength of their domestic financial sector as a base to be leveraged **first** for expansion regionally, and thereafter internationally. Thus, Dubai has thrived as the gateway to the Middle East. Hong Kong has become the financial services gateway for Mainland China. Over the past few years, TT has established itself as the pre-eminent financial center in the region. We should therefore seek to consolidate our position as the financial hub for the greater Caribbean region and as a financial services gateway for Latin America.

What are those achievements on which we could leverage?

Figure 1: Table on Selected Economic Indicators - We have established an enviable record of solid economic performance.

Figure 2: Shows that the financial sector has contributed importantly to the growth in the non-energy sector: even currently it employs some 12 per cent of the labour force.

Figure 3: Financial System Soundness indicators point to a solid financial sector. The table shows that banks are well-capitalised, have low delinquency rates etc. all of which points to generally prudent management and effective supervision.

Figure 4: Our financial sector has made important in-roads into the regional market. Our local banks account for about 60 percent of total bank assets in the region. Our insurance companies account for a similar share of total regional insurance business and our banks have about 15 percent of their portfolio in offshore loans, the bulk of which is in the region.

1. Strong Macroeconomic Fundamentals

	2003	2004	2005	2006	2007p
Real GDP (%)	14.4	7.8	6.1	12.2	5.5
Energy (%)	31.4	8.2	8.4	21.4	4.4
Non-Energy (%)	6.7	6.7	5.0	6.6	6.7
GDP per capita (US$)	8,860	10,234	11,762	14,788	16,090
Unemployment Rate (%)	10.5	8.4	8.0	6.2	5.9
Public Sector Debt/GDP	49.9	44.6	37.6	30.5	28.3
External Debt/GDP (%)	13.2	9.9	8.4	6.3	5.6
Current Account Surplus/GDP (%)	8.9	13.4	23.7	25.5	16.2
Gross Official Reserves (US$ Mn)	2,007.5	2,539.1	4,014.9	5,134.1	6,673.5
International Ratings Standard & Poor's	BBB-	BBB+	A-	A-	A-

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2. Macroeconomic Fundamentals

	Non-Energy GDP /per cent/				
	2003	**2004**	**2005**	**2006**	**2007p**
Non-Energy GDP	**6.7**	**6.7**	**5.0**	**6.6**	**6.7**
of Which:					
Agriculture	*-15.3*	*-34.2*	*-9.2*	*-0.9*	*-5.9*
Manufacturing	*12.0*	*5.2*	*12.6*	*9.4*	*8.0*
Construction	*23.4*	*8.1*	*13.4*	*4.3*	*5.2*
Finance, Insurance & Real Estate	*7.3*	*21.7*	*0.4*	*1.2*	*10.5*
Memo: Contribution of Financial Sector to Total Employment	8.4	8.3	7.8	8.2	8.3

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3. Financial System Soundness Indicators

	2003	2004	2005	2006	2007
Total Assets (TT$Bn)	62.8	71.2	82.9	92.9	103.9
Annual Growth in Total Assets (%)	11.2	12.9	16.5	11.9	11.8
Asset Quality:					
Nonperforming Loans to Gross Loans (%)	2.6	3.7	2.7	2.7	1.4
Earnings and Profitability					
Return on Assets (%)	4.0	5.2	3.6	4.6	4.8
Return on Equity (%)	29.9	36.1	25.0	31.8	33.9
Capital Adequacy:					
Core Capital to Risk Adjusted Assets (%)	19.1	18.3	18.8	18.6	17.9

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4. Banking System Credit:

Domestic and Offshore

Trinidad & Tobago /per cent/	Dec-05	Dec-06	Dec-07
Domestic	**76.0**	**75.3**	**79.3**
CARICOM	**20.0**	**16.3**	**14.6**
of which: Barbados	2.8	2.3	2.5
Dominican Republic	0.6	0.4	0.3
Grenada	0.6	0.5	0.4
Jamaica	4.6	2.9	2.0
St. Lucia	5.0	4.7	4.5
Suriname	0.5	0.5	0.4
Belize	0.6	0.5	0.1
Guyana	0.5	0.4	0.4
Rest of the World	**4.0**	**8.4**	**6.1**
of which: United States of America	3.0	6.0	4.4
Total	**100.0**	**100.0**	**100.0**

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In addition to banking and insurance, we also provide regional leadership in other segments of the financial sector. For example, with increasing incomes, a vibrant wealth management industry has been emerging, centered on deferred annuities by the insurance industry and mutual funds, which has expanded significantly in recent years. Funds under investment in the industry have reached TT$34.5 billion, of which about TT$8.5 billion is denominated in foreign currency.

Yesterday someone put the question, where could we start with the TTIFC? Let me offer some suggestions. It's my view that even as we launch a search for middle and international bank partners … we can start with what we have. Thus,

- **It would be useful to have an international bank as anchor… what about RBC**? If my understanding is correct, RBC has already committed to use Trinidad and Tobago as its headquarters in the region – just as Deutsche Bank was important for Dubai's IFC, RBC could play the same role for Trinidad and Tobago. If RBC is not a possibility … is Citibank a candidate … notwithstanding current fortunes, they are a strong bank with a long history in Trinidad and Tobago and in international reach.
- The Mutual Funds industry would provide a convenient regional niche. We can be a centre for mutual funds and collective investment vehicles in the region. UTC is leading the way, mobilizing savings up and down the Caribbean and even in the US. And there are other mutual funds that are operating regionally and involved in worldwide investments : Canada, India.
- And what about institutionalizing in the IFC a center for regional bond issuance. Even without an IFC, we are doing some of that already. Bond issues for regional sovereigns and corporates have amounted to close to US$1 billion over the last five years. And this industry has spawned a rudimentary derivative market for strips and participations. The investment funds are coming from savings in Trinidad and Tobago as well as from institutional investors throughout the region. It is a question of organizing the industry with appropriate legislation.
- Yesterday, it was mentioned that the stock exchanges of Jamaica, Barbados and Trinidad and Tobago had agreed to establish an integrated platform known as the Caribbean Exchange Network. The next step will be a common platform with a single order book i.e. a regional stock exchange. Since IFCs are about clusters of financial services, the TTIFC would seem to be the natural home for the regional stock exchange. And as the SEC will explain in greater detail, there are proposals for increasing the range of offerings, through the introduction of depository receipts.
- Yesterday, a few speakers suggested leveraging our high reserve levels and the HSF to lure external fund managers to the IFC. If I am asked, I would urge great caution in making that link. In my view, you select Fund managers for their ability to deliver target returns given the country's risk tolerance. A Fund Manager's preparedness to have an office in Trinidad and Tobago should not be given too great a weight in the selection decision.

If the herd instinct works at all, the success in consolidating Trinidad and Tobago's position as the regional financial center could pave the way for extra-regional institutions to acknowledge Trinidad and Tobago as the gateway to the Caribbean, and perhaps to Latin America where the possibilities are even greater.

Data from the IMF's portfolio investment survey show that portfolio investment into Latin America from the US, amounted to about US$258 billion in 2006. Credit from US banks to Latin America amounted to **US$68 billion**. Is there a role for TTIFC intermediating some small part of these sizable cross-border flows? I think the challenge is, will we be able to make it attractive for recognized investment houses to make TTIFC a base for these transactions rather than Colombia or Chile or Brazil or Argentina as is currently the case. To make such inroads we will need, inter alia, to improve transportation links and IT connectivity between TT and Latin America.

What about the Central Bank's role in all this?

As the Minister of Finance noted yesterday, the Bank has already taken important steps to upgrade our supporting financial infrastructure, in line with the requirements of an IFC. Our infrastructural framework now comprises **electronic clearance and settlement systems**, a regional credit rating agency and an online auction system and integrated securities depositories.

I should note that we also have a good base in terms of the availability and quality of supporting services such as law firms with experience in financial law, and accountancy and auditing practices.

We are now upgrading our financial sector legislation and bringing our regulatory regime in line with international best practices. We have completed drafts of new legislation to combat money-laundering and the financing of terrorist activities as well as new flagship legislation governing banks and non-banks – the Financial Institutions Act (FIA). My understanding is a new draft Securities Industries Act (SIA) has also been completed. We are also well advanced in the preparation of a new **Insurance Act and a Credit Union Act.** We plan to accelerate our work on the preparation of new Pensions legislation.

In all cases, the new legislation will aim at adapting well-accepted international best practices to our local situation. Thus for example,

Anti-Money Laundering Legislation is critical to any IFC. No large overseas financial institution will come without it. The **Anti-Money Laundering Act** will provide legally enforceable means for the application of best practices governing Record Keeping, Retention of Records, and Know-Your-Customer Reporting and Compliance requirements. The passage into law of these Regulations will also ensure that Trinidad and Tobago is compliant with the relevant international benchmarks established by the Financial Action Task Force.

The **FIA** would now provide for the consolidated supervision of groups in order to effectively assess and address the risks to regulated entities within a group. It would also place greater emphasis on risk management and improve corporate governance practices. These principles would also be applicable to those companies wishing to operate under the aegis of the international financial centre.

The new **Insurance Act** will broaden the investment rules and give more flexibility to the companies to make investments including foreign investments.

The **Pensions Act** is also likely to provide greater scope for foreign investment and a more open approach to equity investments.

The establishment of an IFC will require the strengthening and upgrading of our financial supervision capability.

Yesterday, there was the question on whether the IFC and the domestic financial services industry should be on the same regulatory footing. The Bank's preliminary view is that all financial institutions should be subject to consistent regulatory oversight. If companies operating within the International Financial Centre are also engaged in domestic lending and investment and are therefore competing with local institutions, they should be subject to the same rules.

In our view, the existence of an IFC does not alter the basic objectives of financial sector supervision which are, preserving financial stability, protecting depositors' and policyholders' interest, and the promotion of a competitive and efficient financial system to support economic growth. Given the fact that companies in the IFC will receive tax advantages, we would need to consider what steps could be taken in order to minimize regulatory arbitrage.

As the IFC expands, the need for a Single Regulator, as distinct from the Central Bank will have to be faced. The Government has indicated that over the medium term it is prepared to consider the establishment of a Single Regulator. In this regard, the Irish example may be instructive.

I thought I should end by going back to my conversation I had with my friend from the Dubai Financial Center. To be fair, he did underscore that there were considerable benefits to be derived from the establishment of an International Financial Center. **But he was careful to remind me that there are costs**; and some of the costs that he mentioned would loom even larger in our society, given our set of political and social institutions.

I was reminded that, a major challenge for a developing or emerging market country with an International Financial Center is the need to **avoid negative contagion between the IFC and the domestic economy**. And this can happen in several ways; it could come from the extensive use of domestic savings to finance offshore lending; it could come from the use of capital inflows to finance domestic lending. The point is that once you have an IFC operating in both the domestic economy and offshore, there could be negative consequences from a sudden reversal of capital; obviously regulation would need to mitigate these risks.

Second, in a small country like ours, **there is always the risk that the IFC increases competition for the scarce technical and managerial resources**, draining the domestic financial center; we do not yet have an IFC and already there is aggressive competition for talent in the financial sector. So that's something that we should be mindful of – the need for accelerated training.

One potential cost of an IFC that is often cited is this; it is argued that attaining IFC status and successfully maintaining it effectively constrains the economic and financial policies of the home country to those that are consistent with this status: policies such as financial sector openness, an open capital account; the absence of exchange controls and non-discrimination between domestic and foreign institutions.

And perhaps one can mention one other potential spillover that needs to be watched and it's the tendency for IFCs to produce a new high-wage elite, many of whom are part-time residents but, who like the oil sector expatriates, could add to the upward pressure on real estate values and high-end rentals. This is an issue that many financial capitals and new IFCs like Dubai have had to deal with.

The Bank strongly supports the introduction of an IFC since there are significant benefits to be derived therefrom. We think that there is sufficient to start with, utilizing some of our domestic institutions which have already made their mark regionally and internationally.

We should be prepared to start with small gains and build as we go along. If we get the policies right, over the long run Trinidad and Tobago could emerge as an important financial hub not only for the Caribbean and Latin America, and perhaps even further afield.