

Ewart S Williams: Impact of financial crises on the Caribbean

Opening remarks by Mr Ewart S Williams, Governor of the Central Bank of Trinidad and Tobago, at the Caribbean Centre for Money & Finance (CCMF)/Caribbean Community (CARICOM) Secretariat and Caribbean Regional Technical Assistance Centre (CARTAC) Workshop on Regional Financial Stability, Port-of-Spain, 3 March 2010.

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Salutations/Welcome

Congratulate CARTAC/Caricom Secretariat/CCMF for organizing the workshop... It is timely and perhaps long overdue.

Our region has had its fair share of **financial turmoil** over the years. Here in Trinidad and Tobago during the 1980's for example, we experienced the collapse of several finance houses; this was followed by problems with three indigenous banks which led eventually to a merger in 1993 of the three domestic banks. The 1980's and 1990's also saw the demise of several indigenous banks and other non-bank financial institutions in the wider Caribbean region.

All of them paled in comparison to the financial crisis that hit Jamaica in the later 1990's. If my memory serves me right the resolution of this crisis is estimated to have cost around 30% of GDP.

There are two things that make the current financial crisis involving CL Financial and its subsidiaries different:

- (i) its enormous size; and
- (ii) its regional character.

In effect, the crisis has involved not only Trinidad and Tobago (with Clico, British American, Clico Investment Bank and CMMB), but it has also touched Barbados, Guyana and Suriname (that have Clico subsidiaries) as well as the OECS and the Bahamas which house BAICO insurance companies, all CLF subsidiaries.

Of course in addition to its scope, the regional crisis has also attracted intense attention because it comes on the heels of the collapse of the Stanford Empire which had regional repercussions and in the midst of an international financial crisis which has been characterized as the worst for almost a century.

While the region, perhaps initially, ignored the incidence of financial stress suffered by individual territories and while we faced only limited contagion from the international financial crisis, it is clear that the current regional financial crisis is an important wake-up call; one that we cannot ignore: one that carries powerful lessons that we need to address immediately.

Experience tells us several things about financial crises viz:

- (i) that the world being what it is, they are going to occur from time to time; and
- (ii) that they could be **very costly** – they always lead to a loss of output and private savings, they carry heavy fiscal costs associated with public bailouts, and they could lead to a systemic loss of confidence in the financial system which is difficult to rebuild.

Examples covering both advanced and developing countries suggest that while financial crises differ as to their details, they always reflect the **confluence of some underlying economic vulnerabilities** and a specific crisis trigger.

The underlying vulnerabilities could be any of a number of things: poor risk management by financial institutions; mis-matches between assets and liabilities; excessive leveraging of

financial institutions, poor liquidity management or inadequate capital. The trigger could be anything, depending on the country – terms of trade shocks, the collapse of an asset (housing) bubble, or macro-economic setbacks resulting from exogenous shocks.

Sometimes the specific event that can trigger a crisis is unpredictable and **crises themselves are also unpredictable**. In fact, many triggers are exogenous and we can do very little about them. In these circumstances, our focus therefore should be on identifying and addressing underlying vulnerabilities early so as to reduce their incidence.

Recognition of this reality – the need to detect emerging problems has led to the development of **early warning signals** and more recently to the preparation of financial stability reports by Central Banks. Some international financial institutions, have compiled a set of macro-prudential indicators to serve as barometers of the health and stability of the financial system and to provide early warning of potential problems.

Our monitoring system in the Caribbean has been rudimentary at best, on non-existent and fragmented, in many of our regional jurisdictions. This is unfortunate since any robust analysis would have shown up a whole range of vulnerabilities **in all of the financial institutions of the CLF conglomerate**. Some of the more glaring vulnerabilities were:

- (i) **a mis-match between assets and liabilities**, with mostly short term liabilities paying above market interest rates, matched by long term assets;
- (ii) **excessive leveraging** of balance sheet assets, reducing their net value;
- (iii) **a preponderance of inter-group transactions**;
- (iv) the total absence of a risk management framework; and
- (v) inadequate capital.

Of course, these vulnerabilities were compounded by:

- (i) a weak legislative and regulatory infrastructure, in which CLF, the parent holding company was not subject to formal regulation;
- (ii) poor internal governance; and
- (iii) insufficient regional regulatory collaboration.

This was a potentially lethal combination, and when energy and real estate prices fell, triggering depositors' and policyholders' concerns about the state of the Group's finances, the inevitable happened.

What started in Clico had widespread contagion effects in the region, in particular among the BAICO subsidiaries located in the OECS.

The message from this regional crisis is clear and it is that **we must urgently address our weakness to strengthen regional financial stability** (so that we could better deal with financial shocks).

I see the main lessons from the regional crisis as follows:

- √ the urgent need for all regional jurisdictions to strengthen national financial legislation and regulatory practices. Moreover, it is important that jurisdictions co-ordinate their efforts so as to reduce the risk of regulatory arbitrage;
- √ a second imperative is the establishment of a framework to facilitate close collaboration among regional regulators in the regulation of cross-border institutions. There is a proposal for a "College of Regulators". It is important that this be up and running as quickly as possible; and
- √ the third imperative is the establishment of a national crisis management plan which details how regulatory authorities would react in the event of a systemic financial crisis. Admittedly, the development of such a plan raises complex issues, not least

of which is the vexing question of whether there should be institutions that are “too big to fail”.

An examination of the workshop’s programme suggests that most of these issues will be covered in the next two and a half days. It is also very gratifying to see the very impressive list of presenters and participants. This should provide for stimulating discussion such that at the end of this workshop we should be able to benefit from new insights for assuring regional financial stability.

I would like to again thank the CCMF, CARTAC and the CARICOM Secretariat for organizing this workshop. Participants I welcome you all to Trinidad and Tobago and wish you all a stimulating two and a half days.