# Ewart S Williams: Upgrading financial regulation and supervision – a multi-dimensional challenge

Regulators Round Table Presentation by Mr Ewart S Williams, Governor of the Central Bank of Trinidad and Tobago, at the Unit Trust Corporation Investor Conference 2011, Port-of-Spain, 8–9 September 2011.

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The last few years have been a difficult period for regulators all over the world. In particular, the global financial crisis of 2008/9 exposed gaps and weaknesses in the international financial architecture as well as in national regulatory systems. This situation has spawned a series of reform initiatives, directed in the main at the major financial centres, but with strong pressures for consequential upgrading of the regulatory systems in emerging market and developing countries.

In the advanced and emerging market countries regulatory reform has focused on:

- tightening prudential criteria (through larger and better quality capital and liquidity buffers);
- **strengthening macro-prudential supervision to reduce pro-cyclicality** and guard against a build-up of systemic risk;
- improving international financial standards;
- strengthening crisis resolution mechanisms; and
- **broadening the regulatory perimeter** to include all systemically-important financial institutions.

The G20, which has responsibility for the international reform agenda, has identified the priorities for developing countries to include:

- strict application of the Basel I framework and adherence to the Basel Core Principles together **with the adoption of a clear time-table for moving to Basel II and Basel III**;
- adherence to international standards and codes, for example, IFRS, FATF standards for anti-money laundering as well as other standards applicable to the insurance and securities sectors; and
- the promotion of regulatory cross-border co-operation on information exchange.

While our financial system as a whole was not directly affected, **the global crisis was one factor that contributed to collapse of the region's major conglomerate, CL Financial (CLF)** and the difficulties faced by its two main financial entities, Colonial Life Insurance Company (Clico) and the Clico Investment Bank. In turn, the collapse of CLF had contagion effects on financial and non-financial firms that had exposures to the conglomerate as well as to other regional economies.

What has turned out to be our domestic financial crisis certainly underscored (if ever there was doubt) **the urgent need for modernising financial sector legislation and upgrading financial regulation and supervision**.

To be fair, Government had adopted a program of regulatory reform as early as 2004. However, the implementation of the program was somewhat slow perhaps in part, **because of the misplaced perception that there was no urgency**.

The sharp slowdown in the economy towards the end of the decade and the Clico crisis collapse laid bare the serious gaps in our legislative infrastructure and in our regulatory processes.

**We took a major step towards upgrading our financial sector legislation** with the passage of a new Financial Institutions Act **(FIA) in December 2008**. While this relates specifically to the banking system, **it is basically framework legislation** that establishes the principles for the other pieces of financial sector legislation.

Work to upgrade financial legislation has picked up pace in recent months and it is now expected that the **Insurance Bill** would be presented to Parliament before the end of this year; and **new credit union legislation** by early next year; and a separate law for contributory pension schemes, later in the year.

A new Securities and Investments Act is also in the offing and I am sure that Chairman of the Securities and Exchange Commission (SEC) will have more to say about this….

I want to make the point that while we are making reasonable progress in upgrading our legislation and while, in recent years, the Bank has made important strides in improving regulation, like other developing countries **there are some critical challenges that we need to overcome to significantly improve the effectiveness of our financial regulation**.

The challenges have to do with encouraging a culture of good corporate governance: getting institutions to buy into higher standards of transparency and disclosure: establishing steps to promote market discipline: taking measures to promote market discipline: and establishing new mechanisms for regulatory co-operation.

## Corporate governance

**A recent OECD report** noted that **poor corporate governance is invariably at the root of most failures in risk management**. In my view, that was the crux of the problem with Clico and is a potential problem with many financial institutions in Trinidad and Tobago.

**Boards of Directors need to insist that they be given information on the risks their institutions face and on the measures being put in place to mitigate these risks.** However, to serve as an effective layer of checks and balances, **board members need to have the requisite industry skills and expertise**. In the small Caribbean space this is a real concern, given the limited availability of qualified professionals willing or able to sit on corporate boards.

**Good governance is a mindset** and pivots on boards setting the right tone and working to ensure that this tone is translated throughout the entire organisation.

**Boards need to operate in a manner in which there is healthy tension** between themselves and management. While the Board's job is not to second-guess management, effective governance dictates that they act aggressively, responsibly and in a timely manner to avoid problems and to resolve problems when they are detected.

Good governance also imposes onerous responsibilities on **auditors** (both external and internal) and **actuaries** (in the case of insurance companies) who are expected to perform their duties in accordance with industry and international standards of practice.

## Greater disclosure

**Inadequate disclosure** is a major challenge to effective regulation in Trinidad and Tobago. A recent IMF assessment confirmed that the information now being submitted to the regulator is grossly inadequate for effective regulation and we are working to correct that. There is also a problem with the information made available to the public.

Our system of disclosure leans heavily on the reporting of results with invariably insufficient detail. I am suggesting the need for increased focus on qualitative disclosure covering an institution’s governance and risk management practices and the challenges it faces. **As regards timing**, currently the law requires banks to report annually, but many report semi-annually on a voluntary basis. There is a case to move to a quarterly cycle as obtains in advanced and emerging market economies and to have large institutions publicly explain their results to their shareholders and the investing public.

## Market discipline

Of course **increased disclosure is critical to fostering market discipline** which plays an important role in ensuring proper risk management. Effective market discipline plays a part in restraining companies from taking excessive risk. The absence of market discipline creates a **moral hazard** problem as too much emphasis is placed on the Regulator. Regulatory authorities as well as financial institutions could facilitate greater market discipline **by promoting financial education programmes which increase** the level of financial literacy and confidence of the consuming public.

## Regulatory cooperation

We have begun a fairly successful programme of regulatory cooperation with our Canadian counterparts (OSFI) in respect of the Canadian banks that operate in our jurisdiction. We are also setting up similar arrangements with our regional counterparts. We need to tighten our regulatory co-operation with other domestic regulators, including the SEC. This would be particularly important as steps are taken to increase regulation of systemically important institutions such as the UTC, whose operations span both the mutual fund and banking industry.

I need to join with Deborah by noting that supervisory capacity, that is, having the right skill sets, continues to be a challenge for the Central Bank and perhaps other regulators. This applies more for insurance than banking supervision.

I should note that we are making rapid progress in addressing these gaps. For example, we now finally have more actuarial support, and in the case of banking supervision, we are making use of retired professionals who bring an expertise that could only be gleaned from years of experience in the field.

My parting words are that regulation is a **multi-dimensional challenge**. It requires all stakeholders (boards, management, auditors and actuaries) to work both independently and collaboratively to be effective. We are gaining ground, but we still have much to do.