Ewart S Williams: Financial risk management

Opening remarks by Mr Ewart S Williams, Governor of the Central Bank of Trinidad and Tobago, at the Caribbean Centre for Money and Finance Conference, Port-of-Spain, 26 March 2012.

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Good Morning Ladies and Gentlemen

Let me add my own words of welcome to all our participants of this very timely seminar on Financial Risk Management. As you know, the seminar forms part of a wider project involving the central banks in the Caribbean/CARICOM region. The project is being funded mainly by the Inter-American Development Bank (IDB) that has partnered with the University of the West Indies (UWI) and Caribbean Centre for Money and Finance (CCMF) to make this initiative possible.

I would like to say a special word of welcome to former ***President of the Caribbean Development Bank and now acting Executive Director of the CCMF, Dr. Compton Bourne*** and ***Mrs. Michelle Cross-Fenty, Country Representative of the IADB, which is a major sponsor of this Project***. Welcome also to all our distinguished participants from our regional Central Banks and regulatory bodies and from the international and regional financial institutions. I also thank the media for their presence.

It is no secret, ladies and gentlemen, that our financial systems have been severely tested in the last few years by the outbreak of the global financial crisis whose powerful shock waves have not only rattled financial markets the world over, but also triggered a deep recession with which many countries are still grappling.

For the most part, regional financial systems displayed remarkable resilience to the global financial crisis, even though our economies were buffeted by the global recession that ensued.

Regional financial systems, however, faced their own challenges arising from the collapse of the ***Stanford Bank*** and more notably, from the demise of the largest regional conglomerate, ***CL Financial***. The stresses faced by CL's financial subsidiaries (Clico Insurance, Clico Investment Bank (CIB), British American and BAICO) tested the foundations of the regional financial system, which even so, proved to be resilient.

Two aspects of what has become to be known as the "Clico crisis" are worth mentioning.

The first is its regional reach: it entrapped in its net, not only Trinidad and Tobago, but also Barbados, Guyana and Suriname (that had Clico subsidiaries) as well as the OECS and the Bahamas, which housed BAICO insurance companies, all CLF subsidiaries.

The second aspect that stands out is its tremendous cost. The bill is still accumulating but for the region as a whole, the cost could be somewhere in the vicinity of 10–15 per cent of regional GDP.

For all its negatives, ***the Clico crisis served as an important wake-up call to the region***. Coming on the heels of the global financial turmoil, it was a clear reminder of the need to strengthen our financial and regulatory systems, so that they could withstand exogenous shocks and it underscored the idea that a co-ordinated regional approach was needed.

It was against this background that the CARICOM Heads' of Government, at their July 2009 meeting requested regional central banks and other stakeholders to put in place a framework for regional financial stability to increase our resilience both to exogenous shocks and to intra-regional stresses.

It is worth noting, ladies and gentlemen, that the objective characteristics of our region make a strong case for the regional approach to financial stability. We are small economies, with extensive economic links, with high vulnerability indices, compared with other regional groups (like, for example, the EU). Moreover our islands are dominated by a short list of over-lapping financial institutions.

On the downside, however, we currently have no regional regulatory institutions. Specifically, we have nothing like the European Systemic Risk Board which has some regulatory authority. The closest we come to a regional regulatory authority is the ECCB, which covers only the OECS. What's more, given the current state of the regional movement, I am not sure of the ***chances for a pan-caribbean regulatory authority***.

Putting aside this issue for the time being, I would like to address the question, "***What should be the main elements of a new regional financial stability infra-structure for the Caribbean region?***"

And, I would like to propose the following:

- First – the region ***needs strengthened financial sector legislation***, in the first round covering the banking system, the insurance and the credit union sectors;
- Second – we need to ***substantially upgrade financial sector supervision***;
- Third – all countries should have deposit insurance;
- Fourth – all countries should have national crisis management plans; and
- Fifth – building on these national plans, we need to formulate a regional crisis management plan.

Permit me to say a few words about each of these elements.

In many countries in the region, ***including my own***, financial sector legislation is grossly deficient when compared to what obtains in advanced or emerging market countries. We, in Trinidad and Tobago, recently introduced a modern Financial Institutions Act to cover the banking system and new insurance legislation is currently in Parliament. Some countries in the region have been upgrading their banking legislation ***but the situation is not as promising with regard to insurance legislation***, which remains woefully outdated in the entire region. This must be seen against the background that both the Jamaican financial crisis of the late 1990s and the Clico/BAICO regional crisis originated in the insurance sector.

In principle, ***strengthened, harmonized legislation would be the ideal*** to forestall regulatory arbitrage. However, the obstacles faced by the CARICOM Model Financial Institutions Bill clearly demonstrated the potential challenges likely to face any kind of harmonized financial legislation.

Countries in the region also need to ***upgrade financial sector supervision***, including the introduction of consolidated supervision. I am told that a first attempt is currently underway to ***conduct a supervisory exercise on a systemically important institution***, with cross-border operations, involving supervisory teams from different jurisdictions. This is an important initiative and I hope that over time these kinds of exercises could become routine examples of regional regulatory cooperation.

More and more countries are adding ***stress-testing*** and the use of financial stability reports to their supervisory tool kit. Properly used, these could provide early warning signals and improve the assessment of threats to the financial system. ***I know that the preparation of financial stability reports is an important component of the IDB-financed project***, and I would like to return to this topic later.

Deposit insurance schemes could contribute significantly to the maintenance of regional financial stability, as they protect lower-income depositors and prevent bank-runs. A harmonized regional deposit insurance scheme would be ideal but the obstacles would be formidable. National schemes should still be regarded as an important part of the regional stability infrastructure.

Because financial instability can sometimes arise without adequate warning, ***all countries should have a national crisis management plan***, to be able to move quickly and to contain the potential cost of a national financial crisis. Such a plan invariably requires close coordination between the various national regulatory bodies, the Government and other stakeholders, ***and should constitute a kind of road map*** to the process of crisis-resolution. The element of certainty that such plans bring, bolsters consumer confidence and facilitates quick crisis resolution.

A regional crisis management plan is another indispensable part of a regional financial stability, but it is the element ***that is likely to present the greatest challenges***. The critical pre-requisites to such regional plan are (i) agreement on what constitutes a systemic threat to the regional financial system; (ii) the existence of information sharing protocols among regional jurisdictions; (iii) agreement on the strategies to be considered in the resolution process and on the guiding principles for cost-sharing in the event that public intervention is deemed necessary.

A crisis management plan for our region is likely to face several challenges, ***among which are differences in legislation or supervisory approaches across*** the region; competing national priorities or differences in resource availability among the regional governments.

The implementation of a regional crisis management plan requires a high level regional council with the authority to make binding decisions as to the use of resources. This could be another challenge in our current circumstances.

I would like to make a few comments on one of the critical components of the IDB-financed project – ***the preparation of comparable regional Financial Stability Reports (FSR)***. We need to remember that these reports are designed to serve as early warning signals by pointing out to policy makers the key risks and vulnerabilities faced by policy makers. Most financial stability reports do this by reporting the latest level of key financial soundness ratios. There is a new body of research that suggests the assessment value of these reports could be enhanced by including at least a qualitative discussion of the near term outlook for these ratios based on various policy assumptions.

I fully recognize, of course, that the preparation of these FSRs is resource intensive and particularly challenging for smaller central banks. Thus, conferences and seminars, like this one, where we bring our ideas and experiences together, are an invaluable learning opportunity. We need to leverage off each other if we are to do this exercise successfully. As all of you know all too well, the range of dis-aggregated commercial bank information that central banks in developed countries take for granted is sometimes difficult to collect in our region where the culture of disclosure is not deeply rooted. This makes our effort to develop FSRs all the more challenging but at the same time all the more necessary.

Let me end by wishing you all two days of very stimulating discussions. I am confident that this conference will further our efforts at strengthening regional financial stability and I thank the CCMF and the IDB for making all this possible.