Catherine Kumar: Setting the agenda for hemispheric progress - developments in the Caribbean region

Presentation by Ms Catherine Kumar, Inspector of Financial Institutions, Central Bank of Trinidad and Tobago, at the VII Annual Assembly of the Assocation of Supervisors of the Banks of the Americas (ASBA), Atlanta, 2-5 June 2004.

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Introduction

Good morning Ladies and Gentlemen, let me first thank ASBA for their kind invitation to address you on behalf of the Caribbean Region at this very important Conference. It is indeed a pleasure to be here at my first meeting with ASBA as a group since I only recently joined this prestigious group of Regulators.

As I prepare to present to you on the issues and challenges that are currently facing us in the Caribbean region, I would like to first update you on some important supervisory changes that have occurred in Trinidad and Tobago over the last few days. As many of you are aware, our Government had been working assiduously to have the Central Bank of Trinidad and Tobago assume the role of the Supervisor and Regulator of the insurance industry and registered pension plans. This has become a reality as an amendment to the current Insurance Act was enacted May 25th, 2004. The challenges resulting from this Amendment as you would imagine are many for me and I look forward to your support. The Insurance Industry has been expanding borders within the region and doing this without proper supervision or regulation. It is the Central Bank's mandate to correct this and to do it with urgency.

Ladies and gentlemen, the supervisory bodies in our region are facing many challenges as a result of globalization. The CGBS therefore chose the theme "Towards Effective Regional Financial Sector Supervision within a Globalized Context" for this year's Conference to deal with some of the issues. The presentations were very thought provoking and in most cases solutions/recommendations were offered, that the CGBS will be seriously considering and implementing as considered necessary. Let me thank Jamaica and Deputy Governor Audrey Anderson for their leadership of the Caribbean Group of Bank Supervisors.

It is not possible for me to discuss with you today all the issues raised at the Conference but I would like to focus on two major areas and the supervisory response. These are (1) the imminent establishment of the Caricom Single Market and Economy (CSME) and, (2) the ongoing challenges of consolidated supervision. I will conclude my address with an update on the developments in Trinidad and Tobago.

The CSME

There is no doubt that this meeting today is taking place at a time when global growth prospects are strengthening, but unfortunately this is happening with significant downside risks such as massive payments imbalances and an impending transition to a higher interest rate environment. In fact, the ramifications of globalization are clear when we analyze the effects on many of our smaller and vulnerable economies of a likely hike in interest rates in the United States and generally the shifting global interest rate environment. The continued volatility in world petroleum prices is also another factor which impacts most if not all of our economies.

We therefore have to agree that the global liberalization of trade and finance is now well established and we have to accept that there is no turning back for any of us in the region. It is against this background that the Caribbean is rapidly forging ahead towards its goal of a single market and economy (CSME) by December 2004. Caricom member states have agreed to remove restrictions on capital mobility, on the establishment of businesses and on the movement of prescribed skills among our countries. As Ambassador Narace who heads the Trinidad and Tobago CSME Unit said recently: "If we are to succeed from the new hemispheric arrangement offered by the Free Trade of the Americas it would be important for the Caribbean to develop strong Caribbean brands and the CSME does exactly that by providing the environment that would create that". The Caricom Secretariat has already produced a Caribbean Single Market and Economy Bill and the CGBS has received information of work begun by the Caricom Secretariat on a model Caribbean Banking Statute. In fact, members have been asked to submit their comments on the document that has recently been circulated.

Some immediate and obvious concerns that the CGBS has with the Bill include:-

- the reconciliation of CSME provisions with international supervision standards and requirements, for example, the need for differential credit ratings in securities originating from other member states based on international capital adequacy standards;
- difficulties with the harmonization of the different legislative frameworks before the dismantling of entry barriers; and
- the role and status of MOUs under the new proposed arrangements.

Some of these issues were discussed at length at our recent CGBS Conference in the paper presented by the representative of Barbados in respect of the Harmonization of Regional Legislative and Regulation Framework within the Context of Globalization, a copy of which is available at your request.

I will share a joke with you which I find meaningful.

"A group of executives got together for a high-powered meeting. At the round table discussions they each put their cell phone down; you know we cannot go anywhere without *this* which has become part of us. There was much heated discussion and juggling of papers back and forth. Sometime after, the cell phone rang and the executive answered:

- "Hello".
- "Hi sweetheart. I am so glad I got you. The real estate agent came around and said they can let us have the house for $5 million. I know it is a bit expensive but I really loved that house. Can I please commit?"
- "Sure darling, for you nothing is too expensive. You can commit to $5 million.
- "And you know that luxury boat we saw - I think it would be so romantic, we can sail up the islands. Oh how I would love to own it. It only costs $2 million."
- "Alright it is my gift to you. $2 million is fine. You are my greatest love."
- "And of course I want to sport that 5 carat ring on my finger when we go out and I hold your hand. I can see the other ladies admiring us. The jeweler said he can make me a special offer of $1 million for it. Can I tell him yes?"
- "My sweetheart sure you can, take the $1 million ring. Bye."

At the end of the conversation, much to the surprise of the others at the ease with which he made such major decisions without proper study and analyses, the executive said:

"Excuse me gentlemen, but whose cell phone is this?"

The moral of this joke - while the CGBS is working on its commentary, we have to ensure the Caricom Secretariat is not making quick decisions on our behalf which could have a long and consequential impact on effective supervision.

I wish to emphasize however that the CGBS supports any arrangement that results in the strengthening of the region's legislation and supervisory framework but we must ensure that proper measures are in place to manage transitioning and in respect of the CSME, address concerns of jurisdictional independence.

Colleagues, the effects of globalization are forcing us to come together as a region to try to buffer our smaller economies from the downside effects. The CSME is one of the ways but it is not perfect and so we need the combined efforts including our Latin American colleagues to make it work.

At a recent seminar in Barbados, (The Advocate May 22, 2004) the Governor of the Central Bank of Barbados had indicated the need for the formation of credit rating agencies in the region to be of assistance to investors who do not have the time or the training to conduct their own credit analyses. She was at the time discussing regional capital market developments and the fact that there must be a credit culture in which investors in general should be able to accurately evaluate risks and returns and determine investment and financing trends, based on the results derived from such evaluation exercises. I am pleased to inform you that the Caribbean Community has finally established its own rating agency, the Caribbean Information & Credit Rating Agency Limited. The Agency has a capital base of three million dollars and is the world's first regional credit rating agency offering rating products in 19 countries. Crisil Limited, India's leading ratings, financial news, risk and policy advisory company, provided the technical assistance and has acquired a 9% stake in the agency and its Managing Director and CEO is on the Board of the rating agency. Crisil will continue to provide the assistance to the Agency to ensure the stability of the operations. This establishment of a regional credit rating agency is indeed a positive step towards a regional approach to critical issues. The agency will commence operations in October 2004.

As our region continues its move to the CSME we must also be prepared for increased competition especially in the area of jobs as the marketplace becomes more unified. It is very important that our professional resources must become multi-tasked and multi-disciplined in order to be flexible enough to adapt to the new challenges. This is an area that member states must be able to manage efficiently through cooperation.

I now turn to the issue of consolidated supervision

The concept of consolidated supervision has been around for a while. The Basel Committee on Banking Supervision has been promoting this concept by developing a series of best practices for banking supervisors including the Core Principles for Effective Banking Supervision (1997) that has become the world standard for effective banking supervision. Those countries in our region which have experienced FSAPs by the multilateral agencies such as the IMF and World Bank, would know the importance of adhering to these Core Principles.

Furthermore, the imminent introduction of the new Capital Accord (Basel II) has renewed focus on this area as there is an assumption in the Basel II methodology that consolidated supervision is practised.

The implications of the foregoing in terms of supervisory oversight are serious as the banking organizations in our region continue to be in an expansionary mode external to their home environment. To quote from ASBA's planning document - "The Banking Industry continues to evolve, leading to a greater concentration, complexity, technological advancements and cross-functional integration within the industry across banks and non-bank operations." When this is coupled with the development of new markets and new products through technological innovations, the possibility of supervisory arbitrage and the blurring of lines between financial products, we must admit that as Supervisors our plates are full and possibly overflowing. More emphasis must therefore be placed on the fundamental elements of risk management practices of both financial and non-financial firms and we have to be up to the challenging task of supervising financial conglomerates with cross-border operations, all of which are critical elements of consolidated supervision.

The CGBS in recognizing the challenges ahead sought to build on the sturdy foundations already in place by exploring fresh approaches to meet the needs of members, fostering and enhancing collaboration within the group and integrating the supervisory practices in response to the emerging issues in the regional and international landscape.

This included the following:-

- The need for accurate and timely data and information to inform the development and enhancement of financial legislation to facilitate the practice of consolidated supervision.
- A refinement of supervisory approaches to address evolution in regional financial markets, e.g., growth in cross border establishments, e-banking and other developments.
- Training of staff at different skill levels and for differing skill sets to better supervise the rapidly evolving institutions in our regional markets.
- Technical assistance in the practical applications of new and/or emerging international supervisory standards and supervisory frameworks, e.g., anti-money laundering measures, Basel II.

In addition, the Technical Working Group of the CGBS as part of their mandate and with participation from 9 member countries formulated a regional response to the Basel Committee with respect to the Third Consultative Paper (CP3) issued by the Basel Committee. A copy was forwarded to ASBA. This response together with responses from individual jurisdictions can be found on the BIS website.

The Working Group has developed a template for the Quantitative Impact Study (QIS) to be used by each member state to assess the potential impact of Basel II on supervised institutions. In Trinidad and Tobago, we have begun the process with one of our large institutions and we have been receiving their full cooperation in acquiring the relevant information. At this time, I would like to acknowledge the role of the Bank of Jamaica in providing the resources and the infrastructure without which the Working Group would not have been able to meet its mandate. We therefore congratulate this sub-committee on the progress made and we in the region sincerely thank the Bank of Jamaica for their efforts.

There is no doubt that consolidated supervision with the attendant impact on our ability as a region to adhere to the New Accord is indeed a challenge. In the meantime our institutions continue to become more complex raising the issues of potential contagion and the effective management of systemic and liquidity risks. The need for specialists in our supervision departments to deal with these and other emerging complexities such as financial modeling, is a matter that we must address as a region.

As I conclude my address, I would like to leave you with an update on the developments that are currently taking place in Trinidad and Tobago and which will certainly have an impact on the region as a whole.

The financial sector of Trinidad and Tobago is considered robust as it has been experiencing an uninterrupted period of positive economic growth over the last decade due primarily to the increased activity in the energy sector. However, there is an element of caution being expressed by both the private and public sectors that this is the time to put in place updated regulatory and preventative measures to ensure that potential risk exposures in the financial system are significantly minimized. It is clear that the Government is adopting a proactive approach to ensure that we do not have a repeat of what took place in the 1980's when we experienced the collapse of several financial institutions in Trinidad and Tobago. As a result of the foregoing, legislative reform is a critical aspect of a White Paper being developed to ensure that Trinidad and Tobago attains first world status by 2020. As I mentioned previously, the Central Bank has assumed the role of Regulator of the Insurance industry. The vision is for a single regulator. In the interim a regulatory council is being established which will provide for cooperation amongst the various regulators.

Whilst legislative reform is critical to address the complexities of the financial sector, other aspects such as the strengthening of corporate governance, promoting market discipline and transparency are critical. It is with this in mind that the Central Bank of Trinidad and Tobago has developed several Guidelines which include Corporate Governance and Fit and Proper Assessment for both banks and insurance companies.

Finally, I would like to say that globalization is affecting us all and as we live in the same hemispheric region I am sure that our Latin American supervisory colleagues present here today are experiencing similar situations as I have expressed today. We therefore need to work together by sharing our experiences and knowledge at Conferences such as this one to ensure that critical issues are addressed for the maintenance of the safety and soundness of our financial systems.

Once again, I thank you for allowing me the opportunity to share with you some of the supervisory issues facing our Caribbean Group as we set the agenda for hemispheric progress.