Marion Williams: The drivers of a changing financial system in Barbados

Address by Dr Marion Williams, Governor of the Central Bank of Barbados, to a seminar hosted by the University of the West Indies Alumni Association and the Barbados Institute of Banking & Finance, Cave Hill, 14 February 2005.

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Good Evening, Ladies and Gentlemen.

I wish to congratulate Professor Frank Alleyne, the UWI Alumni Barbados Chapter and the Barbados Institute of Banking and Finance for conceptualising this forum. It is indeed timely. My topic will be about the changes that we have witnessed in the financial sector in recent years and more especially the likely future changes. In these opening remarks, I will touch on the international and regional influences, technological changes, business needs, changing regulation and their impact on the financial system and on the economy. Further, I will look at the prospects for the sector's performance in an increasingly liberalised and globalised environment.

The past 10 years have seen more changes in international banking than we have experienced in the previous fifty years. Internationally, we have seen banks become bigger as a spate of mergers and acquisitions have taken place. We have seen the banking system become more integrated as banks were allowed to get involved in securities business in many jurisdictions where this was previously prohibited. We also saw the opening up of capital markets accompanied in some cases by increasing levels of volatility.

At the same time, international financial centres like Barbados began to grow significantly and this prompted a well-planned and orchestrated effort to keep them in check. Globalization began to bring with it new levels of risk, and operational risks in banking became a matter of increasing concern. The complexity of banking supervision increased as international regulators introduced new measures of evaluating portfolios. The role of credit rating agencies became increasingly important as potential investors sought reliability of information for assessment investments. Exchange of information and the level of transparency became important issues in judging the credibility of transactions. Guidelines became more and more international in nature and national authorities found themselves faced with a plethora of new rules. Technology in the banking system advanced rapidly to real time settlement, and instant transfer of funds became common place.

Barbados

On the national front, in Barbados, this country saw globalisation and regionalism in action as both the local banks and a regional bank changed hands. We also witnessed a widescale takeover of indigenous banks and for the first time in many years Barbados by 2004 had no local commercial banks.

In the insurance sector we saw a spate of amalgamations which led to the dominance of the sector by a single company. In the non-bank financial sector we saw new competition entering by way of foreign and regional financial institutions.

The credit union movement, which has grown in stature in the past few years, become a significant socio-economic organisation that caters in a large part, to a section of the population which had limited access to credit from commercial banks. They grew in strength and became as large as some of the smaller banks but stopped short of fully challenging them on their own terms. New entrants to the market led to commercial banks became highly competitive, bidding down interest rates by outdoing each other in the marketing of loans.

The distribution sector continued to be an important recipient of credit, and the banking system facilitated this import orientation. Financing of imports continued to receive a major part of the bank's portfolio despite efforts to mitigate reliance on this sector.

Efforts to change this through credit controls worked for a time until methods were found to get around it through leasing, direct lending and other means of financing and until the emphasis on market forces made such approaches appear inconsistent with modern trends.

The Central Bank through its discount schemes offered facilities to key sectors so as to give priority to the productive sectors – in an attempt to encourage a change in lending orientation but the demand for these services remained low. I take this opportunity to encourage the use of the small business guarantee services which have been offered by the Central Bank and which have been heavily underutilised. I would urge banks to encourage their customers to use them more frequently.

Drivers of change

However, liberalisation of the financial industry over the past two decades has helped to support creative financial markets throughout the region, particularly in Trinidad and Jamaica, and seems poised to drive the same type of evolution in Barbados. At the same time, changes in technology have lead to the creation of new financial products and services to automated teller machines to customer credit checks at the teller and to some the development of e-banking. These changing financial industry dynamics have facilitated a growing trend towards increased efficiencies but have entailed major capital outlays.

Increased liberalisation has been accompanied by an increase in the level of oversight and regulation of the financial system. While it is important not to over-deregulate the need for regulation particularly in the area of finance became more important. Greater market orientation needed to be supported by policies that discouraged inappropriate behaviour, but encouraged competition, hence the regulatory framework for the financial sector developed new guidelines for economic interaction within a market environment. New trends in regulation are seeing a shift from prescribing detailed rules and regulations to a focus on identifying risks at the system level, and on ensuring that individual banking institutions have the necessary capacity in terms of internal controls and systems to undertake and manage risks. This was further emphasised by international regulators who pushed greater oversight of the non-banking sector and more anti-money laundering vigilance.

While there has been increased financial consolidation, up to now this has not affected the conduct nor the effectiveness of monetary policy. However, the Central Bank remains alert to the possibility that consolidation can affect the competitiveness of financial markets, and is conscious of the need to continuously monitor the transmission mechanisms with a view to evaluating their impact on policy effectiveness.

Traditional banks face increased competition from new financial service providers as well as new foreign entrants and new technologies for conducting traditional operations in more efficient and effective ways also drive change. A number of firms have sought to increase the use of technologically assisted modes of transacting business, such as Internet and telephone banking. There is widespread acceptance of credit and debit cards and many merchants now have point-of-sale outlets to facilitate the use of varying types of cards. In addition, new technologies, along with the demand for ebusiness, continue to lead to important changes in financial support systems.

The major domestic banks and financial institutions have made significant investments in technology and the cost of keeping up has become quite onerous. Some have entered into alliances with high-technology firms to control the cost of information technology data-processing and this pooling may be a trend which we may continue to observe.

At the level of marketing, some banks have also targeted growth areas, such as corporate and investment banking and have made inroads to the bond market. Changes have also been driven by the new emerging regional economic opportunities and changing customer demands.

High performance of the industry requires that the banking institutions increasingly offer greater product differentiation and value-added services. I expect that in the very near future such demands will require resources to be directed to new areas of research and development in the search for a wider range of structured and customised products. Indeed, there has been evidence of growing consumer involvement in product development and delivery as customers are demanding greater service quality and product offerings. The Central Bank itself started in 2004 a series of seminars on new financial instruments and proposes to continue this in 2005.

Capacity building and infrastructural development

Though efforts have been intensified towards developing a more diversified financial system, responses in some areas have been lukewarm. Small enterprises continue to have difficulty in accessing funds on appropriate terms, and venture capital funds have been limited. So that there are still market segments that are unsatisfied. Investors in the stock market continue to buy and hold, and trading in government securities is very limited, so that instruments continue to lack the needed level of liquidity.

However, competition has resulted in improvements in the turnaround time in processing loans, and in most instances, the response time in resolving customer problems.

Credit growth has rebounded strongly in 2004 and retail lending for consumption generally has increased. Indeed, the banking industry has continued to benefit from strong demand for consumer credit to the detriment of the foreign exchange reserves. But there remains a greater need for institutions to develop more avenues to assist productive sectors. In this regard, not much has changed.

A change in the mode of financial regulation

Given the importance of maintaining public confidence and trust in the financial system, regulation and supervision continue to be vital components of a well-developed financial system.

The Central Bank continued to balance carefully the objective of promoting efficiency in the banking system, and maintaining financial stability, conscious that while competition and innovation are always important stability of the financial system remains of paramount importance.

Opportunities from regional integration

With the imminent implementation of CSME, large businesses and corporations have begun to review their business architecture more aggressively, and have moved to relocate business operations and to operate subsidiary operations in new locations - some of them non-English speaking. This has been accompanied by new ways of organising production, sale and marketing within the region.

The CARICOM region offers a market of approximately 6 million people (excluding Haiti). Opportunities therefore exist for financial institutions to support regional business and investors who are venturing into new activities. The role of banking institutions also needs to extend beyond the traditional one of financier, to one of manager of financial relationships.

Strategic alliances have been growing, and have tended to enhance commercial banks' capacity to compete in both the domestic and external markets, and thus has enabled them to position themselves to capture the opportunities afforded by liberalisation and globalisation, both within a wider CARICOM and outside it.

Customer-focused finance

However, there are areas where more attention needs to be paid. One such area is the need to commit more resources to microfinancing. While institutional arrangements are being put in place to increase access to financing for micro-enterprises at the government level, the banking sector with its large network of branches can become an important channel to enhance its services to this sub-sector.

Conclusion

I envisage further expansion in selected markets outside Barbados will likely become a key strategy for a number of the large domestic financial institutions.

I expect in the near future that since Credit Unions in Barbados will begin to match commercial banks in the range and quality of the services provided and that they will become virtual replacements for indigenous commercial banks.

While the insurance companies which owned banks have disposed of their interests, greater coordination in the regulation of the financial sector will still likely occur as the services supplied by banks and insurance companies become less distinct. Already Registered Retirement Savings Plans offered by commercial banks resemble an insurance product.

In the future pension funds and insurance companies could become more integrated as individuals seek to supplement their pensions, following on the new Pensions Act.

Within the CSME cross-border capital flows are likely to increase and a greater convergence of the financial system is likely to occur. Cross-border ownership of shares in financial institutions is likely to increase and customers are likely to become more discerning as they compare products offered in other jurisdictions in the region.

Greater competition could mean that national development goals may have to struggle to re-assert themselves. Emphasis in profitability and on credit ratings may mean that social and national economic objectives may become even more secondary to financial outcomes. This is likely to place greater onus on moral suasion and on assertions by government of national priorities.

I envisage however, that the domestic financial landscape will evolve into a financial environment that will emerge to meet the future demands of the economy.

We must aim for a world-class financial system that is best able to contribute to economic growth in an environment of financial stability.

I wish you a most informative panel discussion session and I thank you for your attention.

I now formally launch the public forum of the UWI Alumni and the Barbados Institute of Banking and Finance.