

## **Audrey E Anderson: Effective conglomerate and consolidated supervision in the Caribbean**

Opening remarks by Mrs Audrey E Anderson, Senior Deputy Governor of Bank of Jamaica, at the Caribbean Group of Banking Supervisors/Financial Stability Institute seminar "Conglomerate and Consolidated Supervision", Kingston, 11-13 April 2007.

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Good morning ladies and gentlemen. It is a pleasure for me to welcome you, both on behalf of the Bank of Jamaica as well as the Caribbean Group of Banking Supervisors to this seminar on "Conglomerate and Consolidated Supervision" being facilitated by the Financial Stability Institute of the BIS.

I would wish to extend a warm Jamaican welcome to all our visitors from overseas, and especially to **Mr. Amarendra Mohan**, Senior Financial Sector Specialist with the Financial Stability Institute. Mr. Mohan is the primary coordinator of this seminar and will also be sharing with us, on some technical and practical aspects of the supervision of banking groups.

We are also very pleased to have the privilege of the participation of a team of specialist presenters from several overseas jurisdictions who have accepted the FSI's invitation to address the seminar. We have with us this morning:

- **Mr. Denis Sicotte**, formerly of OSFI and now a colleague of Mr. Mohan at the Financial Stability Institute.
- **Mr. Christian Otto**, Head of Group at the Frankfurt Regional Office of the Deutsche Bundesbank responsible for internationally active banks.
- **Mr. Steven P Merriett**, Senior Supervisory Financial Analyst for the Federal Reserve Board's Division of banking Supervision and Regulation.
- **Mr. Thordur Olafsson** of CARTAC who is no stranger to members of the Caribbean Group of Banking Supervisors, having participated in our Annual conference in 2006 and who also acted as facilitator through the agency of CARTAC, for specialized bank supervision training programs and other technical assistance in the region. Thordur also has the distinction of having been Legal Counsel and later Head of Bank Supervision for the Central Bank of Iceland, proving as we have done at the Bank of Jamaica with our own Legal Counsels, that lawyers can make excellent bank supervisors.
- **Mrs. Greta Mitchell Casselle**, Senior Financial Sector Expert with the International Monetary Fund, and formerly a Senior Advisor at the U.S. Office of the Comptroller of the Currency and the U.S. Treasury. Greta is also not a stranger to the Caribbean, having served on several IMF missions to Jamaica and elsewhere in the region, took part in Jamaica's initial Core Principles Review and later our 2005 FSAP, as well as participated in several CGBS conferences.

There are also other speakers whom we anticipate hearing from over the next few days, who are not here this morning but who I would also wish to recognize at this time.

- **Mr. Franz McConney** the Regional Head of Operational Risk at the FirstCaribbean International Bank who will be providing some industry perspectives on risk management and governance in a financial group; and
- **Mr. Gregor Heinrich**, the Chief Representative at the BIS Americas office located in Mexico City, who will be joining us on Friday and will address the seminar on the on the role and work of that office.

We welcome and thank all the speakers for joining us this week and look forward to your respective contributions to the subject at hand.

To our supervisory colleagues from across the Caribbean, ... and I note that we have representatives from nine regional jurisdictions (other than Jamaica) – we are pleased to be your hosts over the next few days and trust that the dialogue, experiences and approaches shared will serve to advance our

individual and collective efforts to enhance our framework and capability to conduct effective conglomerate and consolidated supervision.

The matter of consolidated supervision is very much at the forefront of the supervisory agendas of our member countries. In recent years we have seen growth in financial groups not only in our domestic markets but also in our regional markets, as institutions have sought to defend and increase market shares, gain competitive edge and increase margins. This growth has accelerated significantly in recent years, facilitated in particular, by technological innovations and the lowering of trade barriers.

Most notably for us here in the Caribbean, the advent of the Caribbean Single Market and the prospect of the eventual Single Economy, has seen the removal of certain legal, economic and trade barriers, making it a bit easier for regional financial integration. Over the past decade a number of large regional groups have emerged:

- through diversification into non-deposit financial services;
- through mergers and acquisitions of banking and non banking financial entities; as well as
- through cross border forays.

First Caribbean International Bank readily comes to mind as one such group, as does RBTT/Guardian Life, Sagicor/Life of Jamaica, National Commercial Bank/ AIC to name some – all regional conglomerates with a presence in several regional markets and with product offerings spanning the gamut of financial operations .... here I speak of not only banking, but securities dealing, insurance, money services, pension fund management, and mutual funds.

.... And even as we gather here this morning, there are reports of the possibility of further mergers and acquisitions.

This trend in cross border expansions and conglomeratisation (if I dare to coin such a word), poses a number of challenges and concerns to us supervisors in the region. Primary among these are:

- A heightening of systemic risk domestically and regionally, as financial systems become:
  - increasingly integrated and interconnected; and also as
  - the markets become increasingly concentrated, with fewer and larger institutions.
- Secondly, this trend underlines and emphasizes the need to establish effective mechanisms for information sharing between supervisors, so as to facilitate the monitoring and assessment of potential contagion risks that may originate with entities outside the purview of the domestic authorities.
- And of course, we are faced with the even greater potential for regulatory arbitrage becoming not only a domestic, but a real regional issue.

Against the background of this regional integration of our financial markets, and recognizing that the effective implementation of Consolidated Supervision cannot be the responsibility of one Caribbean Island but must be collectively assumed by the region – the Caribbean Group of Bank Supervisors (CGBS) has adopted a collaborative approach to this issue. In fact, some years ago, the CGBS established a special Technical Working Group with the specific mandate to address the issues of concern. These, in particular include:

- The necessary harmonization of laws and supervisory standards across the region
- A harmonized approach to the restructuring of Financial Groups
- A standardized accounting and reporting framework
- Information Sharing between regional regulatory agencies, and
- Critical training of bank examiners in the region (hence our request for a seminar such as the current one.)

Although much has been accomplished through cooperative efforts, much remains to be done. A significant achievement has been the signing of a Memorandum of Understanding during 2004, initially by those 8 jurisdictions in which the FirstCaribbean International Bank operates. However, in light of the potential for broader application of the MOU, some other CGBS jurisdictions have subsequently

become signatories to this MOU. Additionally, a number of individual jurisdictions also have bi-lateral agreements in place both within and outside the region.

These Information Sharing Agreements have in some instances, also facilitated the conduct of joint examinations of some entities.

Towards, harmonization of supervisory standards, the CGBS Technical Working Group has also been looking at the minimum features to be embodied in respective legislation and supervisory frameworks. A number of proposals have been put forward and have received the endorsement of the Group of CARICOM Central Bank Governors. These include:

- The need to have cross jurisdictional consistency in regulatory reporting and definitions, inclusive of the definitions of what constitutes “capital base” and “acceptable group structures”, in order to avoid regulatory arbitrage.
- The need for regulators to have the ability to prescribe in legislation, the accounting treatment to be used for reporting to the regulator for prudential purposes (especially in instances where conventional accounting treatment or IFRS standards are at variance or inconsistent with more stringent prudential standards promoted for deposit taking entities).
- The need to ensure that the approach taken in amending legislation to conduct consolidated supervision, is consistent with the revised Basel Core Principles.
- The need to further enhance the relationship between the Regulator and the External Auditors if risk based supervision is to be conducted efficiently, since regulators must be able to place reliance on the work of the external auditors.
- And finally, the need for the development of legislation to address the entry protocols and scope of foreign regulators who wish to perform on-site examinations in member jurisdictions.

While the region remains fully committed to applying international best practice standards within respective supervisory frameworks, and is working collaboratively in this regard, the Group however, remains concerned that:

- Small, emerging economies with inchoate/nascent financial markets such as ours, are expected to implement the same international standards developed within the context of, and for application in, large developed economies with sophisticated and highly developed financial systems;
- Multilateral agencies (such as the IMF and World Bank under their Financial Sector Stability Assessment Programmes (FSAPs), assess the region’s financial system framework and infrastructure on the basis of the standards designed for more developed markets, and these assessments inform international opinion on our financial systems and supervisory framework, with significant implications for foreign investment;
- Furthermore, while the best practice standards are established in the Core Principles by the Basel Committee, there is not always the requisite technical guidance needed to interpret the application of the standards. I make specific reference here to the principles that address consolidated supervision of a banking group where a banking group is defined as the bank and its offices, subsidiaries, affiliates and joint ventures, both domestic and foreign. Where I believe further guidance is needed, is in case of group structures such as several in our Caribbean region, that do not fit the classical banking group structure – where for example, the bank is neither parent nor the dominant or significant member of the group, (but which may include other types of regulated financial activities).

The need for this guidance from Basel assumes even greater significance within the context of recommendations being made under FSAP reviews, for the prompt and full implementation of consolidated and conglomerate supervision.

We therefore, would wish to use this forum to urge the international standard setters and assessors to immediately take on board the need to provide detailed and specific guidance with regards to the conglomerate supervision of such group structures, within the context of the Core Principles. In fact, it is our hope that, *in the interim*, this seminar will serve to clarify several of the practical issues with which we are grappling and provide us with clear pointers as to the way forward. In a sense we have

had to break new ground on this issue, developing methodology that is underpinned by the fundamental prudential principles, but which seek to address our unique situation.

I would wish to share with you this morning some of the specific initiatives in which the Bank of Jamaica (BOJ) has been involved in recent years towards the ultimate aim of a having a comprehensive framework in place for consolidated supervision. These have included:

- Establishment of a Financial Regulatory Council (FRC) in 1999, Chaired by the Bank of Jamaica and with representation from the Financial Services Commission – the supervisory authority with oversight responsibility for the non-deposit taking financial sector in Jamaica (i.e. securities dealers, insurance companies, pension funds, unit trusts and mutual funds). This Council was determined necessary to ensure that the necessary legal channels exist for critical communication, collaboration and information sharing especially as regards dually licensed institutions, but more generally, to ensure a coordinated policy approach to regulation of the entire financial system and so also reduce the potential for regulatory arbitrage. To ensure full coverage of all critical issues impacting the system, the Council's membership also includes representation from the Jamaica Deposit Insurance Corporation (JDIC), the Ministry of Finance and the Solicitor General.
- The BOJ also proposed legislative amendments which were passed in 2002 which have enhanced our powers to more effectively carry out consolidated supervision of any corporate group which includes a deposit-taking licensee. These amendments allow for supervisory reach to holding companies, thus enabling such entities to be monitored on a similar basis as its subsidiary banking entity, specifically as it relates to the management of risks and assessment of capital adequacy requirements across the entire group.
- These statutory amendments also prohibit the existence of "mixed" conglomerates. Where such groups do exist, the BOJ now has the power to direct a restructuring in order to facilitate the establishment of a financial holding company, to which the banking entity would report. In exercise of such powers, the BOJ has required, and is currently monitoring, restructuring exercises being undertaken by some of our licensees. The focus of our restructuring requirements has of course been to have, in the final analysis, "supervise-able" groups, with ownership and corporate structures which are not opaque, are fully regulated, and where non-financial risks issuing from other commercial undertakings are kept separate from the financial group.

Audited financials of **all** group entities are also required to be provided to the BOJ, and in addition to its rigorous "fit and proper" due diligence on the principals of licensees, the BOJ now also conducts similar due diligence exercises on the principals of holding companies. The legislation also allows for BOJ to undertake examinations of the bank holding company and to require information of any other group member as determined necessary.

- Further legislative review is underway – in particular an Omnibus statute is intended to amalgamate the various existing pieces of legislation governing banking type entities, into a single overarching statute to create a level playing field across all deposit-taking entities, while preserving the peculiarities of each sub-sector (in the main in the building societies and credit unions sub-sectors). Very significantly, this legislation will also incorporate operational financial holding company regulations which will establish very specific prudential principles for such entities.

I know that several of the jurisdictions represented at this seminar, also have legislation under review or legal amendments already in train to expand their powers for consolidated supervision. I trust that as you interact over the next three days, with supervisors of differing backgrounds and industry practitioners, this will be found to be mutually beneficial in informing further development of our respective supervisory frameworks and practices.

In closing, let me once again express our appreciation to the Financial Stability Institute for its support of training for senior level supervisors in this region, and also to the other organizations, that have so willingly provided facilitators for this seminar.

I wish for all our participants, a very productive week, as you draw on the wealth of experience represented in this room.

We are very pleased to be your hosts and hope that in the near future, you will have the opportunity to again visit our island, but this time to relax and possibly take in the Semi-finals of the Cricket World Cup, and more fully enjoy the hospitality and culture that is so uniquely Jamaican.

Thank you.