Ewart S Williams: Building individual and organisational capacity

Feature address by Mr Ewart S Williams, Governor of the Central Bank of Trinidad and Tobago, at the Co-operative Credit Union League, Launch of Events Calendar 2011, Chaguanas, 26 January 2011.

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I wish to thank the Co-operative Credit Union League for the invitation and extend a Happy New Year to you and your organisations. It has been some time since I have met with the credit union movement, so I welcome this opportunity.

You have suggested that I address the topic ***"Building Individual and Organisational Capacity"***. I am not sure that I could tell you much about this, since your credit unions, in order to survive in this increasingly competitive environment, have had to expend considerable efforts in capacity building. I, however, welcome the opportunity to offer my variation on this theme since, in my view, ***the outlook both for the economy and for your sector will require you to intensify and, indeed, broaden your capacity building efforts***, if you are to maximize your contribution to your membership and adhere to the new regulatory paradigm that is on the way.

Permit me to put my views against the background of the following recent developments:

As you know, the decline in economic activity in 2009 was followed ***by another year of economic stagnation in 2010***. The economic downturn was triggered by the sharp contraction of activity in non-energy sector (most notably construction) and was accompanied by a ***significant increase in unemployment***. The official data show that unemployment rose from a low of 3.9 per cent in the last quarter of 2008 to 6.7 per cent in the first quarter of 2010. I guess, with your close day-to-day involvement in the community, ***you are in a better position to appreciate the real level of employment and under-employment in the country***.

The more challenging economic environment has led to a sharp rise in ***non-performing loans on the commercial banks' balance sheets*** – from 1 per cent to 5 per cent. The ***non-banks***, that cater to a somewhat different clientele have recorded an even more sizable increase in loan delinquency – from around 4–5 per cent to almost 12 per cent of total loans. ***Fortunately, the banking system – both the banks and non-banks***, have the resources to adequately provide for these bad loans.

We, in the Central Bank, do ***not have up-to-date comprehensive data for the credit union sector***. However, the information we have been able to piece together, suggest, ***that the current economic situation is also taking its toll on credit unions as more members face lay-offs and find it more difficult to pay their loans on time***.

In fact, sample data for credit unions (and I should clarify that it is a relatively small sample) ***suggest that delinquency ratios went up significantly in 2010. What's more, it appears that many credit unions have not been vigorously addressing delinquency, for example, through adequate provisions or by writing off bad debts***.

I am also advised that some credit unions (and not only the small credit unions) may still not have recognized the importance of "provisions" or ***know how to provision***. In some cases, it is not clear whether the boards of the credit unions are fully aware of the extent of the problem and thus, in fact, what may be happening is that ***dividend payouts are coming out of reserves***. If that is so, this is certainly not good financial management.

The other "contextual" development that I would like to refer to has to do with the credit unions' exposure in the unfolding ***CLICO situation***. The information which is in the public domain indicates that 65 credit unions had investments amounting to close to $700 million in CLICO. ***That, in itself, is not my issue.*** What is the issue? It is that for some credit unions, the impairment of these investments would threaten their very viability. This suggests that, the management of these credit unions may not have properly assessed credit and investment risks and, ***through insufficient portfolio diversification, almost compromised the viability of their organizations***. Fortunately, it appears that satisfactory arrangements have been made to contain any systemic damage to the credit union sector.

These two situations point to chronic challenges being faced by the credit union sector. You add to these the medium term outlook, in which economic recovery is expected to depend heavily on small business development, and you mix in the enhanced requirements of the new regulatory framework that is being proposed, ***and the prescription is for more and more diversified capacity enhancement, at both the individual and organizational level***.

Permit me to expand on this theme.

As you know better than I, what makes the credit union movement different from the banking sector is your founding principle – ***not for profit, not for charity but for service***. The philosophy of ***"people helping people"*** is the cornerstone of your movement. This philosophy imposes on each credit union and on the movement, ***the obligation to educate their members***. Put another way, "financial education or financial literacy" must be at the top of your agenda.

As the CLICO crisis underscores, the rapid pace of financial innovation requires that financial institutions contribute to providing more information and ***more financial education to the consumer public***. Credit union members consume other financial services – they have variable rate mortgages with commercial banks, they have mutual funds, they have bank loans, some participate in the stock market and ***they need to have the facts in order to make informed decisions*** and to understand their exposure. ***And because of the special relationship of trust between the credit union and its members, you are in a better position than most other people to provide that education.***

I know some credit unions (and I believe, the League) occasionally put on financial education sessions but ***this must become an integral, on-going component of your operations***. Perhaps it could be seen as a "community" service, available to members and non-members alike, in which case the entire country will benefit from your efforts.

I would like to stress that the ***Central Bank stands ready to collaborate*** with the credit union movement or with individual credit unions to further the cause of financial education in Trinidad and Tobago. We would particularly welcome collaborating in ***"train the trainer"*** sessions which offer opportunities for reaching a wider membership.

It is clear that going forward our economy ***will need to depend more on the non-energy sector*** and on job-creation in the small and micro-enterprise sector. ***The credit union movement has stood out as a major source of financing*** for this sector and could be expected to face even increasing demand over the next few years.

To cater to this increasing demand, while protecting the resources of your shareholders, credit unions ***will be well-served by increasing their capacity to provide business services to the clients, to accompany the provision of finance***. The combination of finance and business advice will redound to the benefit of your micro-enterprise borrowers and contribute to reducing loan delinquency.

Again, here is an area in which you could collaborate with other agencies – this time with ***NEDCO, BDC and other SME development institutions***. I am not sure how much of this is being done at present.

Then there is the need for building organizational capacity to prepare for the new regulatory paradigm that is expected to be in place later this year.

Permit me to digress a bit about this new regulatory framework – particularly to clarify what it is and what it is not intended to do.

Formal regulation by the Central Bank is not designed to interfere with or undermine the co-operative (democratic) character of the credit union sector. We fully recognize that this is what makes the sector unique and so important to our economic and social development. The Bank has no intention of stymieing the growth of the sector or closing down credit unions that do not immediately meet the prudential requirements. We do intend to work with the sector to ensure that credit unions are able to operate at standards that are the appropriate standards. We have also ensured that credit unions have a reasonable amount of time (maximum five years) to make the transitions necessary to comply with the new legislation.

What is the regulation intended to do?

In a practical sense, the new credit union regulation will formalize many of the practices that the many credit unions already implement – like managing their financial performance by adhering to the PEARLS ratios. The proposed regulation will now formalize the requirements to have adequate liquidity and capital buffers, to limit borrowing by credit unions and to control related-party lending and investments.

The legislation will also emphasize ***good governance***, which is critical for the protection of shareholders and for effective financial management. For example, Board members will be required to ***meet certain fit and proper criteria and an appropriate level of financial competence, as determined by the credit union***, not by the Central Bank. In turn, the Board will need to ensure that the credit union ***has the systems in place***, including, as a minimum, an audit and a credit committee, to ensure transparency and accountability.

The legislation will provide for strict ***reporting requirements*** and audited financial statements to be submitted three months after the close of the financial year.

I should also note that the new regulatory structure envisages the introduction of a ***mandatory insurance fund*** for the protection of members' deposits and shares. As in the case of the commercial banks, the protection will have a certain threshold, which will be determined in collaboration with the credit union movement. ***It is envisaged that the mandate of the Deposit Insurance Fund will be expanded to cover credit unions.***

Credit unions ***will*** need to build the necessary capacity to operate effectively in line with the new regulatory requirements. I would like to identify four areas:

Firstly, members will need to understand the provisions of the draft new legislation.

Secondly, credit union members will need to insist that their credit unions operate according to the rules and put in place an adequate governance structure.

Third, Board members or those aspiring to be Board members ***may want to strengthen their understanding of the laws and philosophy governing credit unions***, their ability to read and interpret financial statements and to acquire some knowledge of risk management; and

Four, the recent passage of the ***Anti-Money Laundering legislation*** also applies to credit unions. As such, credit unions are expected to put measures in place to ensure compliance with the AML/CFT.

I hope these few ideas help you to plan your activities. I also hope we could continue to work together to bring the Credit Union Legislation and the regulatory framework into operation this year. As you know, we are awaiting Government's approval of the policy framework after which we would proceed rapidly to the ***preparation of the Draft Bill***. Work is proceeding, in parallel, on the amendment to the present Co-operative Societies Act.

It is my firm conviction that the new legislation is in the best interest of the credit union movement and ultimately will strengthen the contribution that the sector could make to the economy.

I end by reiterating my earlier statement that the Central Bank strongly supports the Credit Union Movement ***which has made a significant contribution to the economy over the***

past decade and which I ***am sure*** will continue to play a major part in our attainment of long term sustainable growth and improvement for our entire population.

I wish the League and its membership, the best for 2011.