Jwala Rambarran: The changing face of supervision

Feature address by Mr Jwala Rambarran, Governor of the Central Bank of Trinidad and Tobago, at the Caribbean Group of Banking Supervisors XXXII Annual Conference, Port of Spain, 5 June 2014.

*   *   *

Good morning,

To all our friends from the Caribbean and beyond, I extend a warm welcome to Trinidad and Tobago.

For the next two days, you will be discussing, "***The Changing Face of Supervision***". To us, it's a catchy theme, but just say this to the man on the street here in Port of Spain, in Kingston, or even in Castries, and they will see little connection to their lives.

But if their bank crashed next week and they can't access their life savings, the man in the street would immediately demand an explanation. Fingers would naturally point towards government who would rightfully say "talk to central bank, it's their job". The "who" is to blame would be of little comfort to the man in the street who has lost his money. However, someone must be called upon to account for the bank failure and, of course, that "someone" will be us, the central bankers.

If I sound like I'm talking from experience, well, you all know that I am. Following the collapse of CLICO, our largest insurance company, we at the Central Bank of Trinidad and Tobago, have been listening to these sentiments repeatedly over the last five years, and we know many of you in this room have also had to deal with the contagion effects of the CLICO crisis which sent shockwaves throughout the Caribbean. So, I therefore want to give you three messages, as we begin this Conference on the changing face of supervision.

1. First, let's consider CLICO and its contagion as an early warning for us in the Caribbean region. Let's look at it as a warm up for something even bigger, as the risks to the regional financial system are ominously gathering in the distance...This leads to my second message.
2. Our protection against those gathering storms is changes in the approach to supervision…and finally my third message.
3. The changing face of supervision is each one of you in this room.

I'm going to start with my third message first – you – the face of supervision, as each of you represents the change that needs to occur in supervision. As supervisors you are, of course, distinct from supervision; you are the heads, the reasoning, the human element, while supervision is essentially black or white, there are hardly any shades of grey.

Today's central banker no longer enjoys obscurity. The spotlight has been beaming on us as supervisors for the last six years. Supervision of the financial system is a task, a responsibility and, perhaps at times, a burden, we must carry for our countries. Before 2008, the typical person with a savings account, a mortgage, or an insurance policy, never really cared about who was keeping an eye on the people and institutions managing their money. Now we are more scrutinized than the financial players themselves.

No regulation, no matter how sophisticated, can fully anticipate all potential situations. As supervisors we now have to look at the entire financial ecosystem over which we preside. We must not only pay particular attention to the individual trees but, more importantly, to how their branches intertwine with nearby trees, forming the entire forest and supporting its existence.

In this financial ecosystem there are some who may want to play with fire; and don't care if they burn down the entire forest. Our success, as supervisors, is measured by managing, or even better, preventing fires from actually starting. When they first occur, these may be small fires or sparks that we can quickly stamp out. Such prevention is, of course, much cheaper than the billions it would cost to resuscitate an entire ecosystem.

Here at home, the CLICO fire has so far cost the taxpayers of Trinidad and Tobago over US$3 billion dollars. Three billion US dollars, that's more than the size of eight of our neighboring economies in the Caribbean. In Trinidad and Tobago, that US$3 billion could have built twenty new, state-of-the-art Children's Hospitals, or built and fully outfitted one thousand new primary schools (more than double the existing number of primary schools), or purchase medicine for all our major hospitals for the next decade. CLICO also damaged confidence in the financial sector and left psychological scars on many citizens, in Trinidad and Tobago and in your countries, as well.

Successful supervision happens behind the scenes. It is what the public will never ever see. We will never be thanked for this job, because no one is supposed to see these sparks, far less smell or see smoke. But when we save the day we get to go home with lighter hearts. It's the fires that supervisors miss or could not control in time that bring the villagers running out with their pitchforks and ropes for the fire starters and for us, the supervisors.

So what does this have to do with my third message which in the changing face of supervision is "you". The word "Face" gives supervision a human element, so all supervisors are the face of supervision. So how is the metaphorical/symbolic face of supervision – yours, the supervisors and inspectors – changing?

Good supervision is an extremely challenging and often underappreciated task. At the Central Bank of Trinidad and Tobago, two initiatives are supporting good supervision: the ability to act and the will to act. This is intended to give the face of supervision, our supervisors, more power and presence . . . after all a face should not just be about good looks.

We currently regulate the banking, insurance and private pensions sectors of the financial system, but we are also planning to supervise five systemically important financial institutions, credit unions and bureau de change. We have re-examined the areas we must now supervise and are re-resourcing to suit. We do not have the luxury of time to grow supervisors from entry level to seasoned professionals – a process that can take upwards of a decade. The country will not tolerate the excuse of not having enough competent and highly-skilled supervisors.

We are, therefore, taking a more pragmatic approach to building supervisory capacity. We are aggressively recruiting experienced people from the private sector and placing them in key supervisory positions in the Financial Institutions Supervision Department. We have recruited a Second Deputy Inspector, brought in a highly sought after Chief Actuary and for the first time we have hired a Pension Fund Specialist, Credit Risk Specialist and Anti Money Laundering expert. The faces are changing. They are moving from middle-aged central bankers who came up through the ranks, to more specialized experienced professionals who come from the private sector.

We are exploring all the areas that currently need our supervisory attention and also thinking ahead. We will continue to head-hunt respected talent from the private sector. Let me ask you this question, "What are the backgrounds of your staff in your respective supervision departments?"

Therefore while you are the changing face of supervision, and I've discussed that face and how it is changing and what it should go to, please allow me to address some major changes, not to the face of supervision, but to supervision itself, the black and white.

My second message is about changing your approach to supervision. Your approach represents one of the changes desperately needed for true success, to ensure no sparks turn into raging fires. The CLICO crisis taught us that it's even more important for supervisors at all levels to keep their eyes on the ball, at all times. Here at the Central Bank of Trinidad and Tobago, we are instilling in our supervisors the need to be more intrusive. Our supervisors must no longer stay on the sidelines of regulated financial institutions, relying solely on the results of institutions' "internal controls and risk management systems".

Over the past five years, supervisory priorities at the Central Bank of Trinidad and Tobago seem to have been seriously affected by the CLICO crisis, leading to a more legalistic approach to dealing with supervised institutions. I find supervisors are displaying an overemphasis on compliance and formal letters notifying institutions of sometimes minor breaches, which, in my respectful view, is diverting attention away from important issues of safety and soundness of institutions.

For example, the minutes of one of FISD's "Breaches Meetings" referred to efforts to force a financial institution to address a perceived under-provision for doubtful accounts. These efforts included consultations with the legal department as well as six letters and two emails to the affected institution. I wonder whether this matter could have been dealt with in one meeting following completion of FISD's analysis, in which the institution was advised to make the additional provision, and quietly reminded of the Central Bank's legal powers.

Of course, I fully understand and appreciate the need for enforcement activity to ensure a high standard of compliance with laws and regulation. While this is important, I believe it is not as important as addressing the safety and soundness of financial institutions, whether or not such issues are covered in specific legislative requirements.

Without abandoning the compliance function, supervisors must find ways to balance rules with discretion, and so free up the time for supervision of those issues that could cause an institution to fail, and potentially destabilize the financial system. You must move beyond the compliance mentality, where your inspections are considered thorough once you check the boxes. You must be brave and look beyond, to places that are not on your list of boxes to tick. Supervisors need to move from being inspectors to investigators.

So while supervisors in the Central Bank of Trinidad and Tobago must not stay on the sidelines, if I may humbly suggest, and I know virtually everyone in this room knows this already, ALL supervisors in the Caribbean must become more intrusive. Look for the risks that are not before you. If you identify or suspect a risk, saying nothing, because it is not your territory, it makes you just as culpable as the fire starters.

I know some of you may be taken aback by what I am saying, as we are often warned about straying out of our territory and peeking over fences not in our jurisdiction. However, another change that has come about in supervision at the Central Bank of Trinidad and Tobago is that we have teamed up with fellow regulators and signed Memoranda of Understanding to work with them to share information so we can cover all our bases when it comes to supervision. So if we come across something suspicious that's not in our jurisdiction, we can refer it to one, or perhaps our two partners, the Financial Intelligence Unit and the Trinidad and Tobago Securities and Exchange Commission.

There is the cliché, timing is everything, and this should not be overlooked in the context of our Conference. While you gather and enter into discussions here for the next two days, I want you to keep my second message in mind about the changes to supervision and my third message that you are the face of supervision, so this all rests in you. Let me take you to my first message – the gathering risks to the Caribbean region.

We are in a precarious position right now. Several financial conglomerates control a large market share in many countries throughout the Caribbean and are interconnected to other financial institutions. Please allow me to give three examples of the rising interconnectedness in the Caribbean financial sector.

- The four largest banking groups – RBC Financial, Scotiabank, First Caribbean International Bank and Republic Bank – control about 75 percent of total banking assets in the region.

- In the Eastern Caribbean, many governments and their national insurance schemes are connected to indigenous banks, not only as shareholders but they are also important providers of deposits.
- The Sagicor Financial Group, which has the largest insurance network in the Caribbean, has 60 percent of its investment portfolio in Jamaica and Barbados, making the Group connected and vulnerable to sovereign credit risk events in these two countries, both of which are rated non-investment grade by Standard and Poors. The two largest shareholders of Sagicor are the National Insurance Board of Barbados and Republic Bank.

This increasing interconnectedness is building up systemic risks and raises the chance of financial contagion spreading throughout the Caribbean region, especially if another major hurricane strikes or another government undertakes a significant restructuring of its sovereign debt. I must remind you all that we are living in one of the most natural-disaster-prone regions in the world: the six small island states in the Eastern Caribbean Currency Union stand out in terms of the frequency of hurricanes. A natural disaster can be expected to hit the Eastern Caribbean roughly once every two and a half years. The Caribbean is also home to nine small island states considered to be among the world's heavily indebted countries, with a rising probability of debt default. Grenada is currently negotiating a restructuring of its sovereign debt, which, when completed, will bring to ten (10) the number of sovereign debt restructuring episodes in the Caribbean within the past decade.

We, therefore, cannot afford a tick-box, compliance mentality. As supervisors, we must not underestimate these gathering risks. We must expand cross-border cooperation through exchange of information and policy collaboration. Remember … the Caribbean's financial ecosystem is at stake.

As I close, let me encourage you to use this opportunity for discussion, but not just as a talk shop. Take this meeting seriously, as given our current situation what is discussed here can have the potential to impact the Caribbean region. Take this experience and return to your home, wiser and ready to act.

As supervisors, we need to remember who are at the heart of the financial system. We need to remember it is real human hearts: a teacher with a loan, a market vendor with a savings account in a bank, a bus driver with an insurance policy, or a doubles vendor with an investment in a mutual fund. Our duty is to these market participants, who all rely on us. When the story is told, let it be said you, we as the guardians of the financial system, did all we could in our power, to protect the economies of our region.

To conclude, let me reiterate the following key messages:

- First, CLICO and its contagion was an early warning for us in the Caribbean. Rising financial interconnectedness is building up systemic risks and the likelihood of financial contagion throughout the region. This requires supervisors to see the whole financial ecosystem and not just the individual trees.
- Second, changes to supervision are our protection against those gathering financial storms. Supervisors must be brave enough to move beyond the compliance, tick-box mentality to being investigators, addressing the safety and soundness of financial institutions, whether or not such issues are covered in specific legislative requirements.
- Finally, every one of you in this room must be the desired changing face of supervision.

Ladies and Gentlemen, our work has just begun. I am confident we can continue to improve and learn from each other's experience, applying these lessons to preventing another systemic financial failure in the Caribbean in the future.

I wish you a productive session and hope you enjoy your stay.

I thank you.