Focused and Intrusive

Introducing a New Style of Supervision

Speech delivered by

Mr. Richard Doornbosch

President of the Centrale Bank van Curaçao en Sint Maarten

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Ladies and gentlemen, dear Chairman, dear Derek,

It is a pleasure to be here with you today. Thank you very much for the opportunity to introduce and discuss our New Style of Supervision with you.

COVID-19 has hit us all hard. Our first priority now is -and should be- to protect lives and livelihoods. We expect GDP to contract in Sint Maarten by almost 26% in 2020. This year is not going to be much better, we project only a very small uptick in growth of 3,1% which is not going to be much of a relief. This is the very challenging context in which financial institutions need to operate and manage their risks.

In many advanced economies, financial institutions had repaired their balance sheets and increased capital in response to the global financial crisis. Financial institutions in our jurisdictions did not have a favorable starting position at the beginning of this crisis. Hurricanes, the economic crisis in Venezuela and de-risking by correspondent banks have led to sluggish returns and high operating costs in the decade up to the crisis.

At the same time, we as a central bank were in the middle of a transition process when the crisis hit us. We were reviewing our objectives and responsibilities, the way we conduct supervision and our DNA as a supervisor. The crisis forced us to think through how COVID-19 impacted this transition process and the new style of supervision we were aiming for.

What I would like to do this morning is to share with you the main findings of the review and the paradigm shift we feel is needed to ensure we are achieving our objectives.

Supervisory framework

Important to keep in mind is that financial supervision in Sint Maarten and Curaçao is quite distinct from supervision in many other countries. All supervisory functions for the financial sector are to be found under one (organizational) roof in two countries.

This is different in most other countries. In larger countries with more capacity you will often find a separate banking supervisor and securities supervisor, a supervisor separate from the central bank, and a different organization tasked with conduct of business supervision. The size of the economy in Sint Maarten nor in that of Curaçao allows for separation of these tasks. Economies of scale and scope favor the combination of tasks in one organization. The CBCS is the supervisor of all 442 financial institutions that operate within our two jurisdictions.

Supervisory objectives

The integrated approach to supervision tasks the CBCS with several objectives.

Firstly, the CBCS is fostering the <u>financial soundness of institutions</u>. This is done in the interest of people providing funds. It is aimed at safeguarding the savings people have entrusted to a bank, or a pensioner to receive its pension when he or she becomes [also now in SXM] 65 or your indemnity insurance will be able to pay out the amount insured. This type of prudential supervision focuses on the adequacy of the financial position of institutions, and traditionally has been the core of our work.

Secondly, the CBCS as supervisor focuses on the <u>transparent and fair behavior of institutions</u> towards its customers. In this, we monitor whether institutions treat their customers fairly and financial products deliver what a normal customer may expect from it. Examples include the limitation of interest rates to protect consumers from excessive costs on small loans, assuring that investment funds are transparent about their type of investments and the risks and returns involved and that customers are treated fairly when they have a complaint.

This type of supervision is focused in principle on all financial institutions operating in our markets, but with an extra focus on micro lenders, investment funds and insurance intermediaries.

The third important area of supervision is in the area of <u>combatting financial crime</u>. Society expects financial institutions to act as gatekeepers that prevent criminal financial transactions being channeled through the financial sector. This is especially linked to the prevention of money laundering through our markets and the financing of terrorist activities.

Our role as CBCS therein is to monitor that financial institutions take up this function as gatekeeper in a professional way, to ensure they monitor their transactions thereon and that if need be suspicious transactions are being reported to the financial intelligence units in our countries. Executing these tasks have been quite challenging. Not only in Sint Maarten and Curaçao but all over the world.

Supervisory approach

The global financial crisis in 2008 as a result of the housing market bubble in the US and the rush to the door that followed was felt all around the globe. Among the many effects it exposed financial and banking frauds, think about the USD 65 billion Ponzi scheme by Bernard Madoff. And the pattern can be seen in many countries I have worked in while at the IMF. The USD 5,5 bn Privatbank insider lending scheme in Ukraine that came to light during the 2014 war with Russia. The USD 1 bn that was stolen from three banks in Moldova, the several billion that went missing from the Bulgarian Corpbank. The impact of these events was felt many years after.

In Sint Maarten and Curaçao hurricane Irma and probably more importantly, the crisis in Venezuela helped expose financial fraud in two large financial institutions in our jurisdiction. This was also a wakeup call for the CBCS and the way we conducted our financial supervision. As a result, we have looked at weaknesses and strengths in our rules and regulations, our work processes, our capacity in terms of resources, the perception of external stakeholders and finally actual outcomes.

The outcome is that we will make changes, both in our supervisory approach and in our day-to-day practices.

First of all, we will move <u>from rules-based supervision to more risk based supervision</u>. In practice, this means that we will focus our supervisory attention to the most risky institutions. Risky institutions are institutions that undertake risky business. It seems obvious, but it underscores the fact that a good understanding of that business becomes key. This includes a shift from knowing laws and rules to also knowing the business. It means having a view on sectoral trends and developments as those can lead to new and emerging risks. For sure the institutions themselves are responsible for their own business. And for sure the executive management of that institution is the one to effectively manage its risks and returns. And if excessive risks are taken that are not effectively managed, it is the board to whom questions should be addressed. But in addition, we as supervisor will be challenging the board and if no satisfactory answers are received it might lead to actions from our side to demand remedial measures.

To give an example I could mention one of our prioritized projects for 2021 on liquidity monitoring and liquidity risk management at banks. In this we will not only look at the standardized liquidity reports we receive periodically, but even more at the actual cash flow information the banks themselves use for their daily operations, their analysis in these figures and the way they manage their liquidity risk in practice by means of the measures they have in place to manage these risks.

Also, supervision will change from a <u>reactive to a proactive approach</u>. In the past, supervision was focused on identifying deviations from rules: a supervisor reacts when a rule has been breached. The disadvantage of such an approach is that the supervisor only intervenes after the fact as the damage has been done.

We want to anticipate on a possible future breach of rules, and demand action by the institution before the breach and potential damage has occurred. For us, this means we need to know the institution more in depth, actively monitor the institution on an ongoing basis and become more intrusive when minimum requirements or regulatory requirements tend to be breached.

It also means that we do not expect institutions to actually breach their minimum requirements since these should be really minima that when breached need to be resolved immediately. So e.g., operating below the minimum solvency requirement set for your bank or ongoing shortcomings in your AML requirements are really not acceptable any more.

Big advantage of this approach is that both for the institution and the supervisor repairing the situation is less costly, less difficult and less time consuming.

As a third change, I would like to mention <u>the focus on significant institutions</u>. Significant institutions are those institutions that have the most material impact on society and the financial sector in case a shortcoming occurs. Significance is determined by factors like balance sheet total, market volume or for instance a unique service or financial product the institution provides to the financial sector. Based on these factors we have done a first analysis on the number of significant institutions in CUR and SXM. [Any guess?] There are about 20 significant institutions within our jurisdictions.

So these will get additional supervisory attention. Also, take into account that such a significant institution might be too big to fail. Which means that as a society we cannot afford to let these institutions go bankrupt.

Last but not least, and this might be a more welcome message, we will not expect all institutions to have similar measures in place in case they experience risks or shortcomings. Instead, we will evaluate whether the <u>measures taken are proportionate to the actual risks</u> the institution runs. So supervision will be less a one-size-fits-all approach. It will become more proportionate. We will take the type, nature and complexity of the risks of activities of supervised institutions into account in determining the level of measures that should be in place to mitigate them.

The consequence is that for clear cut - easy to determine and measure - risks we would expect straight forward measures to be taken, whereas more complex and difficult to determine and measure risks will be managed by means of a more complex set of measures.

Paradigm change

I just talked about processes, techniques, approaches and expected outcomes. But what about our own behavior? What about our DNA as supervisor?

Our conclusion is that foremost we need a paradigm change, a new style of supervision. Supervision that is focused, supervision that is intrusive. What do we mean by that?

Focused in the sense that our supervision should quickly lead to identifying the main issues or shortcomings allowing us to take targeted action before any actual harm is done.

Focused also means getting into the nitty-gritty of the problem and knowing precisely what the problem is. So quickly having an insight where the institution is not in control or compliance and which evidence we have to this.

Intrusive meaning that we will be prompt and decisive in our interventions, and will continue to press for improvements until they are implemented.

Intrusive also means that in case the institution does not react adequately, we will use increasingly stringent supervisory measures to have the institution do the necessary changes.

In this we will have an intervention ladder, in which we start with informal measures that along the way will become more formal, pressing and stringent for the institution, management and supervisory board involved, in as far the supervised entity is not willing to comply on substance and within the timeframe that has been set by us as the supervisor.

One of the reasons for this approach is that when time passes, more damage can be done to the institution, to its customers and to our society. Which makes it important that the period of non-compliance is kept to the minimum.

Interested in more details and nitty gritty of the New Style of Supervision? We have developed a publication on our new approach, our expectations and the changes we made internally. It is my pleasure to launch this publication today and in a minute I would like to formally hand over this publication to you mister Chairman. This publication can also be found on our website in English Papiamentu and Dutch.

For now I would like to close were I started. The crisis we are in is unprecedented and we need to give it our full attention. However, we cannot expect to move back to 2019 after the pandemic is brought under control. Also before COVID-19 the challenges and opportunities to the financial sector were many. Digitization, AML/CFT requirements and cyber security threats all require higher investments while consumers demand a higher service levels and lower costs. This means a transformation is required to survive as the financial industry will not exist as we know it ten years from now. This much we know.

Thank you very much for your attention.