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## **THE T & T FINANCIAL SECTOR – CREATING THE FUTURE WE WANT**

by

*Ewart S. Williams*  
*Governor, Central Bank of Trinidad and Tobago*  
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### Salutations/Welcome

Thanks to the Trinidad and Tobago Coalition of Services Industries for inviting me to participate in this seminar. The line-up of speakers guarantees a very stimulating discussion which should help to refine our vision for the financial sector.

I am on record as being very bullish on the performance and potential of our financial sector. Since liberalization two decades ago the financial sector has expanded significantly, has become much more efficient and diversified and in the process made a most impressive contribution to the rapid growth that the economy has enjoyed.

Currently, the financial sector contributes 12 per cent of GDP and employs 8 per cent of the labour force. The sector is dominated by the banking system (the commercial banks and non-banks) but

comprises a large insurance sub-sector, mutual and pension funds, a sizeable credit union movement and a number of public sector institutions involved in small business activity, agricultural and mortgage financing. The sector is also normally defined to include a capital market that intermediates equities and public and corporate bonds.

The banking system has led the expansion of the financial sector over the past two decades and currently accounts for about one-half of the total of financial sector assets. As personal incomes have grown rapidly, the mutual funds industry mushroomed, with funds under management, at one stage, (in 2004, I think) exceeding the level of bank deposits. The credit union industry has been another growth sector and we now have two credit unions with total assets of around \$1 billion each and three credit unions with assets of over \$300 million.

As is to be expected the development of the financial sector has been a bit "un-even" with banking and insurance showing the fastest growth and the capital markets sub-sector showing a less impressive performance.

The evolution of the banking system over the last decade has been accompanied by significant domestic consolidation and by cross-border expansion. What has happened is that, to reduce cost and improve efficiency, there have been a number of mergers of domestic institutions, while many domestic banks have acquired subsidiaries throughout the region.

Ironically the expansion of the banking system has also seen an important change in ownership patterns. You would recall the trend in the 1970's when the banking system was essentially localized. Currently, (in line with global trends) of the eight commercial banks six are foreign-owned.

Banking system growth over the past decade has been accompanied by a fair amount of product innovation and by the expanded use of technology.

Even with these advances, it is significant that the banks' lending patterns remained virtually unchanged with an emphasis on consumer lending (30 per cent of total lending) while mortgage lending accounts for 24 per cent.

While there have been improvements recently, the available evidence suggests that the small business sector has continued to have difficulty in raising bank finance, in part because of the (real or perceived) higher cost and greater risk of lending to this sector. Bank credit to agriculture also continues to be at minimal levels also for reasons of risk and collateral. For other reasons, the banks have not been called upon to provide significant lending to the energy sector.

Like banking, the insurance sector has under-gone its own transformation. The largest companies all emerged into conglomerate structures increasing the linkages with commercial banks and there has been a discernible shift in product offerings, away from traditional insurance to deposit-like and wealth-management products.

Capital market development has lagged behind that of the rest of the financial system. One segment of the market – for government and public sector securities – has expanded rapidly. At the same time, the banks have created a sizable market for bonds issued by regional governments and corporations.

Equity markets have been the slowest to develop, and have remained shallow and relatively illiquid. There have been very few new listings over the past two decades and following some de-listings in the past two years, the number of listed companies now stand at thirty-one (31) compared with a high of thirty-four (34) in 2008. Market capitalization has declined by about one-third since 2004 and trading volume has also remained very low. With very few IPO's the market has not been a major source of equity capital for new industries.

The reasons for the limited development of the equity market are many among which are-

- (i) The bias in the fiscal system towards debt as opposed to equity financing.
- (ii) A reluctance by private companies to dilute control and to disclose sensitive information to outsiders.
- (iii) An individual investor population that is risk averse.

Even considering the differing fortunes of the various sub-sectors, by and large Trinidad and Tobago can boast of a robust and resilient financial sector. The robustness is nowhere more reflected than in the solid prudential indicators of the banking system

(regulatory capital, non-performing loans and profitability). The system's resilience was demonstrated by its ability to withstand the contagion from the international financial crisis.

That, in summary, is the basic structure of our financial services sector at the present time. What of the future? How can it be expected to evolve over the next few years?

Obviously that cannot be predicted with certainty but I would like to provide some thoughts on the likely direction of its evolution.

In principle, one could expect the evolution of the financial system over the next few years, to be influenced by several factors including, for example:-

- Macro-economic developments.
- Technology.
- The pace and direction of regulatory changes.
- The movement towards regional integration.

Experience world-wide has shown that the size of an economy imposes serious constraints on the financial services sector. Thus, for example, in small economies there will always be limits on the development of our capital markets and banks will also be the dominant players in the market.

Over the next few years, particularly if economic growth is slower than it has been in the past, banking institutions will be forced to compete through improving consumer service, while

striving to reduce costs. These efforts are likely to create further pressures for bank consolidation to achieve economies of scale. New regulatory requirements, including compliance with AML/CFT guidelines would also re-inforce the trend towards consolidation.

Of course, there is a real risk that further bank consolidation could act to reduce competition. This is a challenge that the Regulator will need to address.

There are indications that increasing excess liquidity is forcing banks to compete for scarce lending opportunities. This could redound to the benefit of the small and medium-sized business sector which traditionally has had difficulty in securing bank credit. Public policy, for example, through an expansion in the guarantee scheme administered by the BDC, could accelerate this trend. The need to increase lending could also force banks to look at opportunities in the agricultural sector.

As for the insurance industry, new legislation is expected to lead to a significant increase in the capital requirements, for both life and general companies. The proposed legislation will also impose more stringent statutory fund and claims reserve requirements.

Here again regulatory pressures could be expected to lead to a shake-out of marginal firms from the insurance industry. (It is already beginning to happen).

The outlook for capital market development over the next few years is less clear than for the banking and insurance industries. Our small domestic market dominated by small and medium –sized family firms has acted as a brake on the development of our equity market. In principle regional integration has the potential to address this obstacle by alleviating diseconomies of scale. As some of you may know, for some time now work has been proceeding on the integration of the stock exchange platforms of Barbados, Jamaica and Trinidad and Tobago. This is seen as first step towards the establishment of a regional stock exchange.

Even an integrated regional market may still be too small to attract foreign portfolio investors (as for example, in Chile or Brazil or Mexico). Local and regional market development would receive a boost from privatization of selected state corporations (in Trinidad and Tobago, as well as in other countries in the region) and by getting multi-national corporations (in the regional energy and domestic sectors) to list their regional operations on a regional stock exchange. This has been done in other areas of the world.

Another area that is in need of attention is how we deploy technology to improve efficiency in the delivery of financial services. Over the last few years, we have made some progress in automating our payments systems and in introducing online banking, all geared towards giving customers greater choice and flexibility in their banking and financial arrangements. Despite these efforts, online banking as a mode of delivering financial

services is still not as pervasive as it ought to be especially in an environment in which customers are increasingly making greater use of mobile telephony services and the internet. Many emerging market countries have realized that the internet has become indispensable for developing a competitive advantage in financial services and are investing significantly in deploying web-enabled technology to reach a wider customer base. Some financial institutions for instance have begun to exploit e-social networks such as *Twitter* and *Facebook* to advertise their financial products and to get feedback from their customer base.

Let me end by trying to summarize all that I have said.

We have a very strong financial system – one that has been making an important contribution to national economic development. Over the next few years the system will be tested firstly, to improve service delivery to a more demanding clientele, while reducing cost. This could lead to several changes including consolidation. We expect that along with new regulatory requirements competitive pressures and the need to find new lending opportunities will always prompt institutions to increase their involvement in sectors that were previously underserved (subject to adequate risk management standards of course).

I have argued that the size of our economy and even of our regional economy would limit the potential contribution of our equity markets. Over time regional integration will enhance this contribution. The development of these markets could be

further enhanced by privatization of selected state corporations and by selecting to have the regional operations of certain multilaterals incorporated in our equity markets.