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"Partnering for a New Economy"

Opening Remarks

at

Bankers Association - Banking Week

by

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I am very pleased to be participating in your "Inaugural Banking Week Activities" and I thank the Bankers' Association of Trinidad and Tobago for inviting me to make some remarks at this opening ceremony. At this current juncture when the uncertainties surrounding CLICO and its parent CL Financial, **raise concerns about stability of the entire financial system**, I absolutely welcome the opportunity to recognise the strength of our banking system and to outline some of the challenges that lie ahead.

Some of you may recall that not so long ago - in the late 1980's - the banking system went through a mild version of financial stress. However, following financial liberalization and the restructuring of the state banking sector, the system stabilized and has since grown from strength to strength.

While admitting that the direction of causation is open to debate, there is no doubt that the period 2003-2008 saw both a rapid expansion in economic growth and a virtual transformation of the banking sector. Over the six year span, real GDP expanded at an annual rate of about 8 per cent. While the energy sector was the main growth engine, the non energy sector grew by an impressive 6.0 per cent a year.

During this period also, bank credit expanded at an annual rate in excess of 20 per cent. While consumer credit and business loans registered healthy increases, mortgage loans more than doubled from 7 per cent to 18 per cent of total bank loans.

It is significant, and in some cases counter-intuitive, that this explosion in bank lending was accompanied by an **improvement in the main bank stability indicators**.

- Non-performing loans declined from 3.9 per cent in 2004 to 1 per cent in 2008;

- Profitability indicators strengthened, with the rate of return on assets rising from 2.1 per cent to 3.5 per cent in 2008; and

- Capital adequacy remained robust at between 18-19 per cent, compared with the statutory minimum of 8 per cent.

The onset of the international financial crisis in 2008 created havoc for banking systems in most advanced economies. However, as our banking system was never corrupted by sub-prime mortgages or by exotic derivative instruments, we did not face immediate contagion. As you know all too well, however, the financial crisis led to a global recession which had a profound impact on domestic economic activity and employment.

Even so, our banking system displayed remarkable resilience in the face of the economic decline and the difficulties arising from the CL Financial crisis. This resilience reflected the system's high capital adequacy buffer, and the banks' conservative lending practices. As expected, non-performing loans have increased from 1 per cent to 4 per cent of total loans. However, banks have the resources to make the necessary provisions.

Stress tests conducted by the Central Bank and a recent IMF Mission confirm that the banking system, as well as the individual banks, have **sufficient capital to withstand plausible adverse shocks**.

It is no secret that up to very recently the evolution of the banking system, **in terms of its product innovation, organisational sophistication and complexity**, outpaced that of our banking legislation. (I am pleased to note that, in many cases), **the banking system voluntarily adhered to the higher regulatory standards**, in anticipation of the updated legislation, the new Financial Institutions Act, which was finally approved by the Parliament towards the end of 2008.

Our banks have also been very responsive to pressures to contain service fees and to improve customer service. A recent study by the Bank of Jamaica shows Trinidad and Tobago as having the lowest bank charges in the region, while data from the Office of the Financial Services Ombudsman show that the number of consumer complaints against commercial banks has declined to minimum levels. In part, this reflects the fact that all banks now have internal complaints resolution units, which are operating effectively.

Ladies and gentlemen, it is a widely held view that Trinidad and Tobago is facing a challenging medium term economic outlook – **one that envisages a somewhat smaller contribution from oil and gas and consequently one that will require a more meaningful diversification of the non-energy sector**. The diversification thrust would, most likely, require new growth centres geared to new export markets, as well as a more focussed effort at agricultural and small business development. This new dispensation will pose greater challenges and imply new responsibilities for the banking system. I would like to comment on a few of these challenges.

While our banking system is generally regarded as the most efficient and the strongest in the region, we do not yet compare well with those of the more dynamic emerging markets or advanced economies. That is the higher bar we must now address.

Compared with these economies, banking services in Trinidad and Tobago are still relatively high cost and inefficient. For example, total operating costs for banks in Trinidad and Tobago average about 6 per cent of total assets compared with under 2 per cent in the EU and 3 per cent in the US and about 4 per cent in most emerging markets. Yet, the return on assets for Trinidad and Tobago banks has averaged over 3 per cent compared with 1.2 per cent in the US and 1 per cent in the EU.

The greater profitability of the local banks is related, inter alia, to the high interest margins. The data shows that these margins increased from 7 percentage points in 2004 to 10 percentage points in 2009, before declining to 9 percentage points in 2010. Interest margins are around 2-3 per cent in advanced economies and 4-5 in the high cost emerging market economies.

The relatively high cost of banking in Trinidad and Tobago may be related to two main characteristics – **first**, the limited exploitation of new technologies and **second**, the oligopolistic structure of our banking market which limits competition, allowing banks to maintain their profitability without increasing efficiency.

Clearly the large margins are excellent for banks' bottom line, and for bank shareholders. My banking colleagues always remind me that it is better to make profits than to have losses and I fully agree. But there is a difference between private and social rates of return and particularly, going forward, where banks would be critical to the diversification effort, we need to seek a better balance between the one and the other.

In the long term, a diversified economy that facilitates a steady and sustainable rate of growth is better for banking than an economy of anaemic growth or stagnation.

As regards technology, while transaction volumes have been increasing, electronic banking remains rudimentary in Trinidad and Tobago and has not yet started to produce cost savings for the banks. Our investigations suggest that the still limited acceptance of e-banking has to do with concerns about security, quality of internet connection and a general lack of awareness about internet banking. As regards the latter, a recent survey revealed that 75 per cent of those questioned were familiar with debit cards, while only 22 per cent was familiar with internet banking and 27 per cent with telephone banking.

It is noticeable that not only individuals, businesses and the public sector are still slow in adopting the electronic environment. The Central Bank, in collaboration with the banking system, has invested considerable resources to establish electronic payments systems – the Real Time Gross Settlement System (RTGS), for large value transactions, and the Automated Clearing House (ACH) for small transactions. However, the transition from cheques (and other paper-based systems) to electronic payments has been very slow. The good news is that the Government is working assiduously to establish the necessary legislative and technology infrastructure to move to electronic payments. We would continue to work along with the commercial banks to encourage a faster transition among private businesses.

Ladies and gentlemen, the diversification imperative will significantly increase the need for financing to promote small business development. For several years, official institutions have taken the lead in small business financing with limited success. Traditionally commercial banks have been very cautious in this area because of the perceived risks and the high servicing costs. In recent years a few banks have launched small business financing programmes but these continue to fall far short of requirements.

The reality is that our diversification effort would benefit enormously from a well-funded, comprehensive, small business development programme. This will require a partnership between the Government, business and the banking system. Some elements of this partnership have already been identified. For example, the "fair share" programme that reserves a share of government projects for small businesses is an initiative with tremendous potential. The Business Development Corporation administers a loan guarantee scheme in collaboration with commercial banks, although, based on the latest data available, it has not led to a major increase in financing for the small business sector.

We need to bring the various elements together into a meaningful, coordinated small business development programme and the banking system will need to play a pivotal role in this effort. Other countries, most notably India, Malaysia and Singapore have been able to set up successful small business development programmes. I am certain that, with the support of the banking system, we can also develop a dynamic, viable small business sector.

I would like to close with some brief comments about another area where close partnership would be of invaluable benefit to the population as a whole – and here I am referring to the National Financial Literacy Programme. One of the many lessons emanating from the CL Financial crisis is the urgent need for more financial education, at all levels of the society. While the Central Bank may take the lead, as indeed we have, the commercial banks, as well as other financial institutions, have a significant role to play. With the steady advance of financial innovation, consumers of financial services need to understand the new products that come on the market; they need to understand the principle of risk and reward; to be clear as to which products are insured and which are not. Above all, in this era of sophisticated advertising, consumers need to be able to separate fact from fiction and to make sound financial decisions.

I know that the Bankers' Association and the banks themselves have been doing their part to provide more consumer-friendly information to the banking public. That's commendable, but we need to do much more. (The area of variable rate mortgages is a case in point).

With these remarks, let me again thank the Bankers Association for inviting me to participate in the Launch of Banking Week. I am certain that your various activities will bring significant benefits to the banking public.

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