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*“The New Credit Union Regulatory Regime :
Prospects and Possibilities”*

FEATURE ADDRESS

at the

*Co-operative Credit Union League
Presidents’ Breakfast Meeting*

delivered by

*Ewart S. Williams,
Governor, Central Bank of Trinidad and Tobago
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I would like to express my sincere thanks to the Trinidad and Tobago Credit Union League and to its President, Mr. Gary Cross for inviting me to address you on the occasion of your convention and on the eve of the sixtieth Anniversary of the Credit Union Movement.

Sixty years is a most important milestone; in human terms it used to be taken to mean that your most productive years were behind you; that you could now bask in your achievements and sit down and take it easy. But even that

notion has changed since people are working longer and since there are so many cases in which one's best work comes after sixty.

For institutions, surviving sixty years is usually a good testimony of considerable resilience and a clear indication that you are fulfilling your mission.

(Ladies and Gentlemen), Over the past sixty years the Credit Union Movement in Trinidad and Tobago has not only survived but has thrived and you have done this, I would submit, in part because of the dedication and commitment of a host of credit union leaders over the years but moreso because the movement has evolved and adapted to meet the changing times and the changing needs of its membership.

Born out of the bowels of the common people (as Dr. Ralph Henry put it) the credit union movement has done a fantastic job of providing financial services to a broad cross-section of the society (including groups not adequately served by the traditional providers). If truth be told, the credit union movement deserves much credit for contributing to the development of the savings habit, for educating sections of the population on financial matters and for helping to finance small business investment.

The movement survived the difficult decade of the 80s through adapting to the times and specifically through considerable consolidation, which saw the number of credit unions fall from some 400 to around 164 by 1993. While consolidation has continued (with the number of active credit unions currently at about 130) the movement has blossomed since the mid 1990s, in part, through fiscal support offered by Government and (borrowing some of Gary's words) "by consistently renewing itself with purpose and passion".

But as I indicated in a speech to one of your member unions early last year, in recent years the financial environment has been changing more rapidly

than at any period in our history. The blurring of the boundaries between various sectors of the financial services industry as well as product innovation have resulted in a proliferation of financial options being offered by the traditional providers and **have forced the credit unions to venture into new areas in order to compete and to maintain their membership base.**

Many credit unions now see the need to get into **increasingly riskier activities** in order to survive. The point is, however, that engaging in non-traditional activities without an adequate risk management framework or the required management expertise could put member savings at risk. Moreover financial difficulties in one or two large credit unions could undermine confidence in the entire movement and could conceivably have contagion effects on the entire financial system. **And herein lies the case for formal regulation of the credit union sector** – it is to protect the savings of its members and ultimately to safeguard the integrity of the financial system.

Many of you would recall that the original proposal to bring the credit unions under the regulatory authority of the Central Bank was met with some disquiet, in part because it envisaged some division of the movement by asset size. **I am very pleased to see that we have come a long way from that day.** Permit me to recap where I think we are at present:

- As far as I can judge, the Credit union movement as a whole is strongly supportive of the need for more formal regulation and understands and supports the rationale behind the appointment of the Central Bank as regulator.
- The need to maintain the unity of the Credit Union movement has been accepted and Cabinet has approved the Central Bank as regulator for all credit unions (no longer is the proposal that credit

unions with assets in excess of \$100 million would be under one regulator with the smaller credit unions under another).

- We are also convinced that given the movement's unique character (its cooperative nature, its democratic systems) legislation intended for commercial banks is inappropriate for credit unions. Rather, the need is for specific credit union legislation that recognizes these unique characteristics.

We, in the Central Bank, are about to start work on the preparation of a Credit Union Bill. Let me clarify, as we have done with legislation pertaining to the commercial banks and the insurance companies, we plan to consult and collaborate with the Credit Union League in preparing the legislation.

But arriving at appropriate credit union legislation is going to require **lots of work** as well as compromise and understanding on all sides because **it would imply making changes** in how business is done currently.

As you may know, formal arrangements for the prudential regulation of credit unions are a relatively recent phenomenon. In fact, data published by the World Council of Credit Unions (WOCCU) indicate that only about one-third of 104 member countries surveyed have credit union-specific legislation. In these circumstances, we are currently examining credit union legislation from Australia, Ireland, the United States as well as the model legislation published by the WOCCU to help in the preparation of a draft which will serve as a basis for discussion with the League.

We envisage that appropriate credit union legislation would need to cover the following key areas:

- **Capital Requirements**

The World Council of Credit Unions (WOCCU) lists capital adequacy as a key element in credit union legislation and in its paper on best practices, encourages credit unions to maintain a level of institutional capital. Such capital does not belong to individual members but **to the membership as a whole** and is to be used as a buffer against unforeseen losses which will otherwise be charged against members' deposits. Such capital also helps the credit union remain competitive and supports growth.

- **Other Prudential Criteria**

I would envisage that the prudential criteria under-pinning the proposed credit union legislation would be based on the **PEARLS system with which the movement is already familiar**. With the entry of the Central Bank, the system will be both a management tool and supervisory standard used to assess the financial soundness of the credit union. (As such, I could envisage statutory minimum liquidity ratios: limits on non-secured lending and other prudential targets).

- **Participation in Non-financial Activities**

The legislation would need to address the issue of the non-financial activities of credit unions. These activities have expanded significantly in recent years providing a source of income to supplement earnings from financial activities. It is also argued that these activities provide additional services to credit union members. **From a regulatory viewpoint** these non-core activities can be a potential drain on the credit union's resources; they put pressure on limited managerial capacity and expertise, and pose risks that are outside the supervisory responsibility of the Central Bank. This is a problem that we also face with the rest of the financial system. Thus we are currently working on

amendments to the FIA, which would require a clear separation between financial and non-financial activities of a mixed conglomerate.

- **Corporate Governance**

The draft Credit Union bill will need to formulate guidelines governing the Board of Directors and other supporting committees, e.g. (credit and audit committees). I would guess that this would not be new for many if not most credit unions.

- And finally, there would be need for **Transitional Provisions**

When the new legislation comes into being some credit unions would not be in compliance. However, we would need to discuss and agree on an appropriate transition period to allow credit unions to make the necessary adjustments to meet the provisions of the new legislation. Some of the standard provisions of the FIA and the Insurance Act will also need to be incorporated into the draft credit union bill, with appropriate modifications as needed. These provisions will cover, for instance:

- The authority for the regulator to share information with other regulators, local, regional and international;
- The regulator's ability to levy civil money penalties for non-compliance;
- Financial reporting and disclosure requirements,;
- Fit and proper criteria for directors and senior officers of credit unions;

- Market conduct standards; and
- Anti-money laundering supervisory practices.

I mentioned earlier that the intention was to implement a two tier system of regulation. **Exactly what does this mean?**

One precedent that we can look at is that which obtains in the United Kingdom in which regulation falls into one of two categories depending upon the assessment of the **overall level of risk** associated with the particular credit union. Small credit unions conducting traditional operations will be subject to less stringent requirements. On the other hand, small credit unions with high risk will be exposed to close monitoring. Large credit unions will carry higher ratios and exact closer monitoring because of their high risk to the system as a whole.

Two other points we are going to have to work through are: (i) a framework of co-operation **between the Central Bank, as regulator, and the Credit Union League**; and (ii) over time we would need to discuss the establishment of a **Deposit Insurance System** similar to what currently obtains for the banks and non-banks and a Central Credit Union Financing Facility.

The Way Forward

Getting financial legislation to Parliament involves several stages and could be a time-consuming process. Our schedule calls for having the bill ready for presentation to Parliament by September 2006 – an ambitious agenda.

In line with this schedule we are proposing a session to discuss a policy paper with the League around the **third week of February**. Following agreement on the policy paper we will work towards preparing a draft bill for **consultation with the industry by the end of May**. This would give three months for the various stages involving approval by the Ministry of Finance, the Cabinet and the Legislative Review Committee.

The Central Bank has already appointed a team to begin work – the team is led by the Deputy Inspector of Financial Institutions (Ms. Wendy Ho Sing) and includes a Manager with experience in credit union supervision from Jamaica. I have asked Ms. Ho Sing to be in close contact with the League throughout the process.

As I said, it is an ambitious schedule. However, I am sure that if we hold fast to the **fundamental credit union** principles of mutual support and co-operation we will get it done and we will have credit union legislation of which we could all be proud.

Thanks for giving me the opportunity to address you and, **even if a bit early**, congratulations on the sixtieth anniversary of the Credit Union Movement.