

CENTRAL BANK OF TRINIDAD AND TOBAGO

FINANCIAL
STABILITY
REPORT
2014



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PREFACE

The financial stability objective of the Central Bank of Trinidad and Tobago (“Central Bank”) is to maintain confidence in, and promote safety and soundness of, the domestic financial system. This involves continuous assessment of key vulnerabilities in and risks to the financial system so as to determine its resilience to macroeconomic shocks. Having reviewed its decision-making framework for financial stability, Central Bank introduced a number of changes to enhance its macro-prudential oversight and to ensure greater consistency with evolving international best practices. These changes included creation of a Financial Stability Unit housed in the Research Department and preparation of an annual, rather than semi-annual, Financial Stability Report. The annual Financial Stability Report will identify and assess potential risks to the soundness of the overall financial system, communicate such assessments and foster more informed discussions on relevant financial stability issues.

CHAPTER ONE: ASSESSMENT OF RISKS TO FINANCIAL STABILITY

The global economic recovery was weak and uneven in 2014 and is anticipated to be subdued in 2015. Among the major advanced economies, the recovery in the United States has been stronger than expected, prompting the start of a gradual withdrawal of the extraordinary monetary stimulus put in place by the US Fed over the past half a decade or so. In contrast, recovery in nearly all other advanced economies has been slow, suggesting further policy stimulus may have to be deployed to reduce the overall drag on global growth.

A number of important downside risks to the global economic outlook remain. There are concerns about stagnation and low inflation in the Euro Area as well as in Japan. Some major emerging markets, which supported global activity in the recent past, are losing momentum with spillovers to regional economies. China's slowdown is likely to affect much of emerging Asia. Russia's steep contraction is diminishing economic prospects for the rest of countries in the Commonwealth of Independent States (CIS) group. Mounting geopolitical tensions in Greece, Ukraine and the Middle East also loom. The sharp plunge in crude oil prices since September 2014, should it extend to natural gas and persist for a longer time, is likely to provide some boost to global growth but will weaken fiscal and external positions for Trinidad and Tobago and other energy-producing countries.

Global growth prospects continue to be highly dependent on exceptional and prolonged monetary stimulus in many advanced economies. This monetary stimulus has pushed down long-term interest rates to near historical lows, fuelling investors' risk appetite and a search for higher-yielding assets. The search for yield rallied stock markets, narrowed credit spreads on high-risk corporate bonds, revived segments of the structured finance markets and pushed leverage loan markets to unprecedented levels. More recently, the US dollar has begun what seems to be a trend appreciation against the euro and yen and currencies of many emerging markets have weakened, especially those of commodity exporters.

Central Bank is currently monitoring four key vulnerabilities in Trinidad and Tobago's financial system. These are as follows:

Vulnerability 1: Heavy Dependence on Energy Sector

Vulnerability 2: High Level of Household Indebtedness

Vulnerability 3: Historically Low Domestic Interest Rates

Vulnerability 4: Rising Financial Interconnectedness in the Caribbean

VULNERABILITIES IN THE FINANCIAL SYSTEM

Vulnerability 1: Heavy Dependence on Energy Sector

Trinidad and Tobago has achieved limited success in diversifying its economy away from a heavy dependence on the energy sector. On average, the energy sector is roughly 40 per cent of the size of the economy, contributes half of central government revenues and accounts for 85 per cent of export earnings. The vulnerability associated with the heavy reliance on the energy sector was reflected in Trinidad and Tobago's weak growth in 2014. Economic growth is likely to be just under a modest 1 per cent for 2014, well below the projected growth rate of 2½ per cent. The unexpected, sharp slowdown was caused by supply disruptions mainly from the two largest energy companies, with spillovers most pronounced in lower natural gas and LNG production. A steady performance from the non-energy sector prevented the Trinidad and Tobago economy from veering completely off its growth trajectory. In early 2015, concerns have been mounting about the potential severe negative impact of sharply falling energy prices on the country's fiscal and external positions.

Vulnerability 2: High Level of Household Indebtedness

Record low interest rates, low unemployment and rising disposable income have supported strong growth in household debt over the past few years. Consumer debt stood at roughly \$25 billion in 2013, a cumulative expansion of almost 20 percent from around \$21 billion in 2010. Consumer lending continued to grow strongly in the first nine months of 2014, increasing by 5 per cent to reach almost \$26 billion (Table 1). The build-up in consumer debt resulted from lending to finance real estate mortgages and home improvement works as well as to finance motor vehicles and credit card purchases. Real estate mortgages currently account for the greatest share of consumer loans at over 40 per cent, followed by motor vehicles and other consumer durables which represent approximately 15 per cent. Credit cards and personal expenses account for just under one-tenth of total consumer debt.

Mortgage arrears and credit card delinquency rates remain low, but in the context of rising interest rates, vulnerabilities could be increasing at the margin, as some households engage in riskier borrowing. Mortgage arrears, proxied by non-performing residential real estate loans, accounted for a mere 2 per cent of total consumer loans in September 2014. The average credit card delinquency rate is approximately 2 per cent while the typical annual percentage rate (APR) is around 24 per cent on outstanding credit card debt.

Table 1
Banking System: Consumer Loans by Purpose, 2010 – September 2014

	2010	2011	2012	2013	2014
	TT\$ Million				
Real Estate Mortgages	7,324	8,081	9,207	10,063	10,835
Vehicles & Other Durables	2,834	3,832	3,053	3,381	3,771
Re-financing & Consolidation	2,542	2,844	2,883	3,225	3,173
Home Improvement	2,407	2,529	2,541	2,730	2,870
Credit Cards & Personal Expenses	2,010	2,076	2,145	2,309	2,360
Other	2,878	2,649	2,692	2,861	2,716
TOTAL	19,995	22,011	22,521	24,569	25,725

Source: Central Bank of Trinidad and Tobago.

Low interest rates have not only encouraged some households to take on higher levels of debt, but also seem to be encouraging large, non-financial retail store chains to lend to riskier households. Anecdotal evidence suggests certain retail chains, which are neither regulated by Central Bank nor any other authority, have been rapidly increasing their sales of consumer durables on hire purchase terms to households. With increased competition and no regulation, there may be greater incentives for these retail stores to underprice risk, which would leave them, as well as households, more vulnerable to rising domestic interest rates and negative economic shocks.

Vulnerability 3: Historically Low Domestic Interest Rates

Short-term domestic interest rates at record lows for an extended period of time have affected profitability and asset growth across the financial system. Commercial banks continued to lower interest rates on deposits, as interest income declined, while looking to other sources of income to boost profitability. Non-bank financial institutions have been also affected by the low interest rate environment and subdued capital market activity. Further, the prolonged low interest rate environment is challenging for insurance companies and pension funds that have to meet policyholders' obligations and payments of pension benefits, respectively, but are now earning less income on their investments. In addition,

limited availability of higher-yielding domestic financial assets has led investors to seek investment opportunities abroad, contributing to the rising demand for foreign exchange.

Vulnerability 4: Rising Financial Interconnectedness in the Caribbean

Trinidad and Tobago's increasing financial linkages to the Caribbean bring into sharper focus the issue of contagion and spillovers to its economy and financial sector from regional shocks. Financial sector linkages have increased continuously in the Caribbean with cross border capital flows and financial conglomerates dominating the financial system. Of the eight banks operating in Trinidad and Tobago, three are subsidiaries of large Canadian banks, which, along with the two large indigenous banks, have extensive operations across the Caribbean region. Banks' investment exposure to Caribbean countries is about one-third of total foreign currency exposure, most of which is to Barbados and St. Lucia and comprises mainly private sector equity (58 per cent), corporate bonds (6 per cent) and government securities (5 per cent). On the other hand, loans which account for more than 30 per cent of CARICOM exposures were mainly to the tourism sector in several countries.

This high degree of financial interconnectedness suggests that if a large shock were to hit a country in the Caribbean, the shock may reverberate throughout the region and could pose a material risk to Trinidad and Tobago.

These vulnerabilities in Trinidad and Tobago's financial system could be exposed by a trigger, which could then cause a risk to materialize. Central Bank's assessment of each risk reflects its qualitative judgment as to the probability that the risk will occur and the expected impact on the domestic financial system and economy if it does.

On this basis, Central Bank identified four key risks to the Trinidad and Tobago financial system in 2014 and into early 2015. These risks are as follows:

Risk 1: Sharp and Persistent Fall in Energy Prices

Risk 2: Household Financial Stress and Correction in House Prices

Risk 3: A Spike in Long-Term US Interest Rates

Risk 4: Sovereign Debt Restructuring in the Caribbean

RISKS TO THE FINANCIAL SYSTEM

Table 2 presents a heat map of the key risks to the Trinidad and Tobago financial system in 2014 and into early 2015. The heat map analyzes the likelihood of each risk occurring and the potential impact on financial stability. There are five probability and impact rankings: low, moderate, elevated, high and very high. High impact outcomes are those which would require significant and immediate action from the regulatory authorities, medium impact outcomes require some form of appropriate action from the authorities including stepped up monitoring of the risk and low impact outcomes require no action as yet.

Table 2
Key Risks to Financial Stability in Trinidad and Tobago

KEY RISKS	Probability	Impact
Risk 1: Sharp and Persistent Fall in Energy Prices		
Risk 2: Household Financial Stress and a Correction in House Prices		
Risk 3: A Spike in Long-Term US Interest Rates		
Risk 4: Sovereign Debt Restructuring in the Caribbean		

Low	Moderate	Elevated	High	Very High
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Source: Central Bank of Trinidad and Tobago.

Risk 1: Sharp and Persistent Fall in Energy Prices

The most important risk facing the financial system in Trinidad and Tobago is a sharp and persistent fall in energy prices. This risk is rated as “very high” and by early 2015 was already triggered in respect of international crude oil prices. On January 8th 2015, the Government revised its Budget estimates to more conservative prices of US\$45 per barrel for crude oil and US\$2.25 per mmbtu for natural gas. On this basis, the Government expects to incur an energy revenue shortfall of around \$3½ billion and plans to redirect spending on infrastructure projects for which funding has not yet been confirmed and to cut expenditure on non-critical goods and services and allocations across ministries to close its fiscal gap.

Trinidad and Tobago seems well positioned to withstand the impact of a prolonged period of low energy prices. While the LNG market operates quite differently from the oil market, both commodities are closely linked. LNG prices in some regions such as Asia and Europe are indexed to crude oil prices and have already begun to fall. Central Bank estimates that Trinidad and Tobago is likely to experience the impact of lower than budgeted natural gas

prices from around May 2015 giving the authorities sufficient time to put appropriate policy measures in place.

Towards the end of 2014, Standard and Poor's (S&P) reaffirmed Trinidad and Tobago's investment grade "A" credit rating with a stable outlook, citing the country's strong net external asset position, low external vulnerability, and stable political system in support of the ratings. The current account surplus is estimated to have almost doubled to 13 per cent of GDP in 2014. Available foreign exchange reserves of US\$11 billion could finance five times the country's total external debt. The net asset value in the Heritage and Stabilization Fund stood at US\$5½ billion at the end of September 2014, equivalent to almost one-fifth of GDP. In addition, S&P stated the country's long-established parliamentary democracy and social stability should sustain political consensus on economic policies.

Stress tests suggest an energy price shock involving a 50 per cent drop in energy prices (without a policy response) would have a considerable impact on the capital position of the domestic banking system. The capital adequacy ratio for the banking system would fall by just over 10 percentage points to 11½ per cent of total risk-weighted assets, moderately above the regulatory minimum of 8 per cent.

Risk 2: Household Financial Stress and a Correction in House Prices

The second key risk facing the financial system is the inability of highly indebted households to service their mortgage debt in the face of rising long-term domestic interest rates and possibly a sharp decline in incomes, leading to some correction in house prices. This risk is rated as "high." The most likely trigger for this risk is a sizable negative shock to economic activity, or a combination of shocks, that leads to a prolonged slowdown in Trinidad and Tobago and sharp rise in the unemployment rate from its historical low.

House prices remained elevated during 2014 and into early 2015 and continue to be an area that warrants close monitoring in view of the effect of higher house prices on overall household debt and the exposure of financial institutions to the property market. In 2014, the median price of a 3-bedroom house was 1½ times that of a similar house just six years ago in 2008. Any substantial fall in property prices can add pressures on the balance sheets of financial institutions.

Several factors mitigate risks to households from any potential correction in house prices. As of September 2014, around 2 per cent of residential real estate mortgage loans were classified as non-performing. Based on Central Bank's supervisory monitoring, there is no strong evidence to suggest a widespread trend of home owners increasing their leverage by

taking on more borrowing (through refinancing) against the rising value of their properties. Commercial banks have been increasing their provisioning which will help improve their position to meet potential defaults on residential property loans.

If the risk of household financial stress and a fall in house prices were to happen, banks appear to have very little vulnerability to property price risk. Stress tests indicate a 30 per cent plunge in property prices would have modest impact on the banking system, with capital falling by only 2 percentage points to a very comfortable 20 per cent of risk-weighted assets.

Risk 3: A Spike in Long-Term US Interest Rates

A third key risk for the domestic financial system is a spike in long-term US interest rates. The most likely trigger for this risk is a market reassessment of the future path of US monetary policy. As markets expected, the US Federal Reserve ended its era of quantitative easing in October 2014. For the first time in eight years, the Fed is likely to increase the Fed funds rate, probably in the latter half of 2015.

The sudden reversal of capital flows in some emerging market economies in mid-2013 immediately following an announcement by the Fed that it intended to taper its asset purchase program, highlights the risks to the normalization of US monetary policy. There is considerable uncertainty in global financial markets about the pace and magnitude of these expected increases in the Fed policy interest rate, which can amplify the risk of an abrupt reversal in investor sentiment and capital flows. The effects of these international developments would be rapidly transmitted to Trinidad and Tobago through trade and financial channels.

The possibility of a sudden spike in US long term interest rates continues to be rated as “elevated”. It would likely have a moderate effect on Trinidad and Tobago’s financial system, if the risk were to materialize. Central Bank is already putting measures in place, through available monetary policy tools, to insulate the economy and financial system, as much as possible, from rapid increases in US interest rates. Since September 2014, Central Bank has implemented three consecutive increases in its policy rate – the Repo rate – to 3½ per cent from a historical low of 2¾ per cent, signaling an end to the era of low interest rates which prevailed for the past few years.

Higher long-term domestic interest rates would increase debt service costs for highly indebted households in Trinidad and Tobago, which could lead to a rise in loan defaults and

downward pressure on housing prices. Higher long-term interest rates could also increase borrowing costs for firms, which could lead to some reduction in private sector investment.

However, a gradual rise in domestic interest rates will benefit the insurance and pensions industry, aligning returns on investments more closely with guaranteed future obligations. General insurance, being short term in nature, is generally less sensitive to changes in interest rates.

Stress tests suggest an interest rate shock of an increase of 700 basis points would have a significant adverse impact on the banking system, with the capital adequacy ratio declining by over 12 percentage points to around 9½ per cent of total risk-weighted assets, slightly above the regulatory minimum.

Risk 4: Sovereign Debt Restructuring in the Caribbean

Sovereign debt default and debt restructuring in the Caribbean represent the fourth main risk to Trinidad and Tobago's financial system. About two-thirds of CARICOM countries are carrying public debt in excess of 75 per cent of GDP and they continue to be challenged by widening fiscal and current account deficits, rising unemployment and sharp fluctuations in international reserves. Credit risk of Caribbean governments have risen due to sovereign rating downgrades, the latest being S&P's December 2014 downgrade of Barbados to "B" from "BB-", warning also of the potential for a further economic downgrade.

The most likely trigger for the risk of another sovereign debt restructuring is a combination of shocks such as higher long term US interest rates and weaker growth prospects, especially in the tourism-based countries. Declining oil prices and Venezuela's slide into recession can worsen the situation if it brings into question the sustainability of the Petrocaribe agreement, which supplies crude oil to several Caribbean countries at subsidized prices. With 11 episodes of sovereign debt restructuring in the Caribbean over the past decade, the probability of another sovereign debt default materializing is "moderate".

Stress tests results indicate a regional shock would have a low impact on the domestic banking system, with the capital adequacy ratio falling by about 1½ percentage points to more than 20 per cent of risk-weighted assets and well above the regulatory minimum capital of 8 per cent.

Central Bank of Trinidad and Tobago is spearheading an initiative to develop a Financial Interconnectedness Map which shows financial linkages among banks, insurance companies and other financial institutions in the Caribbean. The interconnections involve ownership, funding channels and exposures to regional sovereigns and corporates. Stress testing of these

financial linkages will help to identify vulnerabilities associated with regional contagion risk and to develop appropriate buffers and mitigating factors.

Trinidad and Tobago's financial system remained sound and stable in 2014 and going into early 2015, providing an environment supportive of growth amid heightened volatility in global financial markets. Stress tests conducted by Central Bank show that, even under the assumptions of adverse economic conditions, the banking system is expected to remain well-capitalized. At the same time, insurance companies, despite constraints of low interest rates, continued to be profitable and to generate new business. As such, their performance and balance sheet positions would be expected to strengthen significantly in the event of a rise in domestic interest rates, as would also be the case for private pension funds.

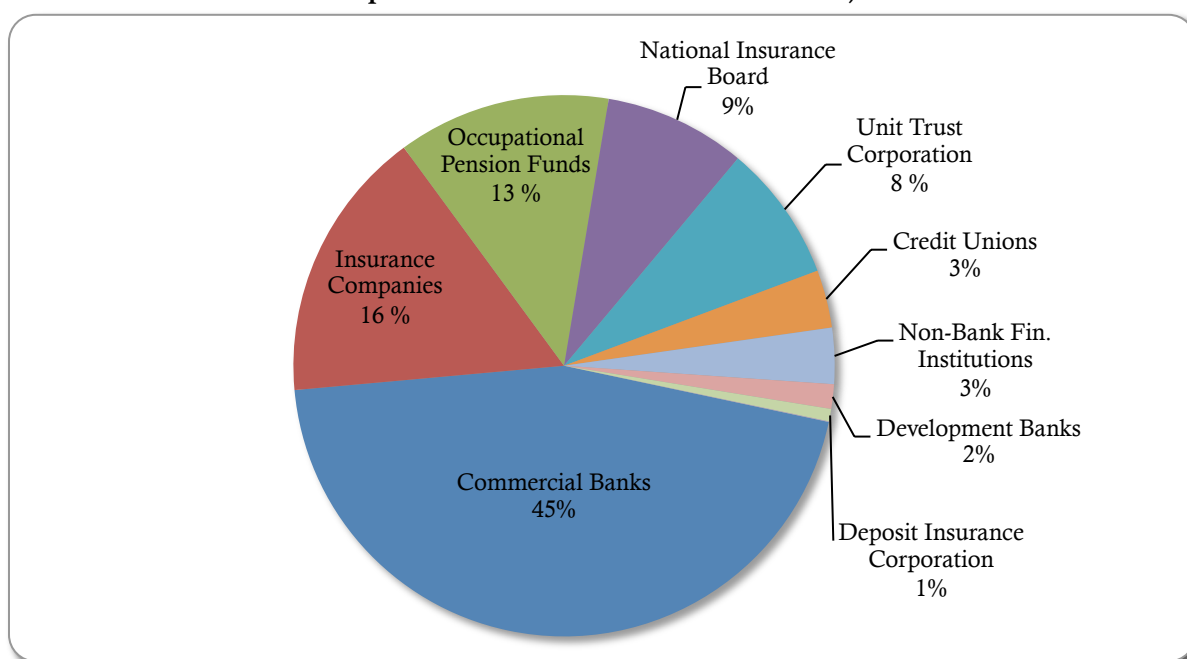
While the external environment will remain challenging in 2015, Central Bank expects domestic financial stability will continue to be preserved. Trinidad and Tobago's financial sector is well-placed to manage attendant risks due to the presence of strong financial institutions, deep financial markets, and continued close supervision by Central Bank. While the overall risks to financial stability are assessed to be well-contained at present, the Central Bank's surveillance and supervisory activities will be maintained at a heightened level of vigilance. Central Bank stands ready to act preemptively to address any build-up of emerging risks and threats to domestic financial stability.

CHAPTER TWO: PERFORMANCE OF TRINIDAD AND TOBAGO'S FINANCIAL SYSTEM

STRUCTURE

The financial system in Trinidad and Tobago accounts for roughly 12 per cent of GDP and plays a pivotal role in the economy given its very close linkages with the real sector. Commercial banks traditionally dominate the financial system, accounting for 45 per cent of total assets in 2013 (Figure 1). Insurance companies are the second largest institutional group within the financial system, holding 16 per cent of total system assets, followed by occupational pension funds with 13 per cent. Other entities such as the National Insurance Board and the Unit Trust Corporation also command sizable shares of financial sector assets.

Figure 1
Composition of Assets in the Financial Sector, 2013

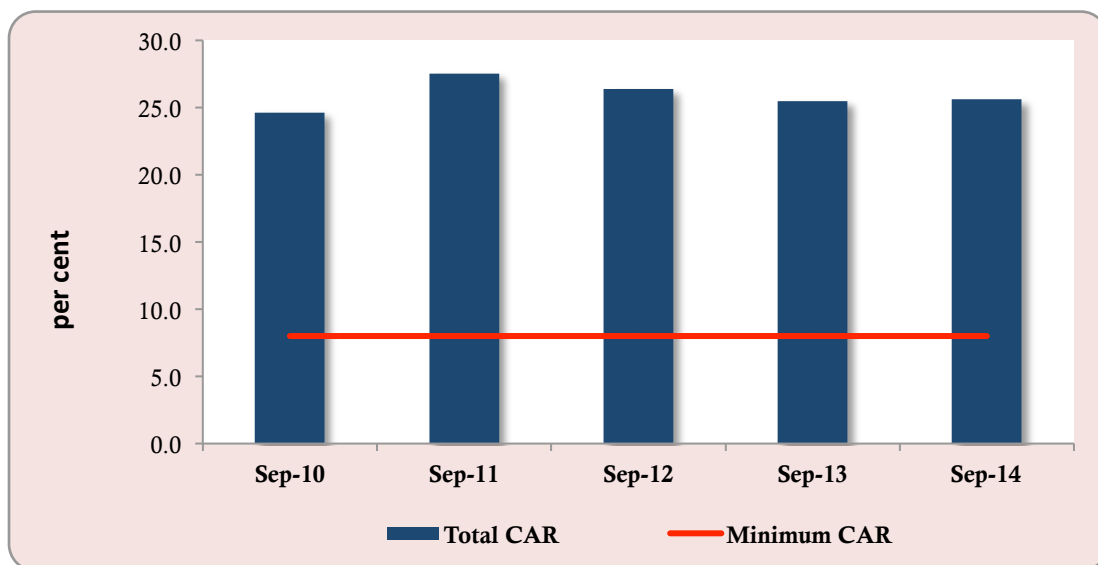


Source: Central Bank of Trinidad and Tobago

BANKING SYSTEM

The domestic banking system appears to be sound and well positioned to withstand negative shocks. As at September 2014, the weighted average capital position of banks, as measured by the ratio of regulatory capital to risk-weighted assets, stood at just over 25 per cent (Figure 2). This is a capital buffer well in excess of the minimum statutory requirement of 8 per cent, indicating the banking system has adequate capacity to absorb potential losses and still remain solvent in the event of substantial financial stress. Tier 1 capital, which is the core measure of the banking system's financial strength, remained at robust levels. Moreover, banks would be able to sufficiently meet additional capital charges arising from the introduction of some elements of Basel II capital requirements in the near-term.

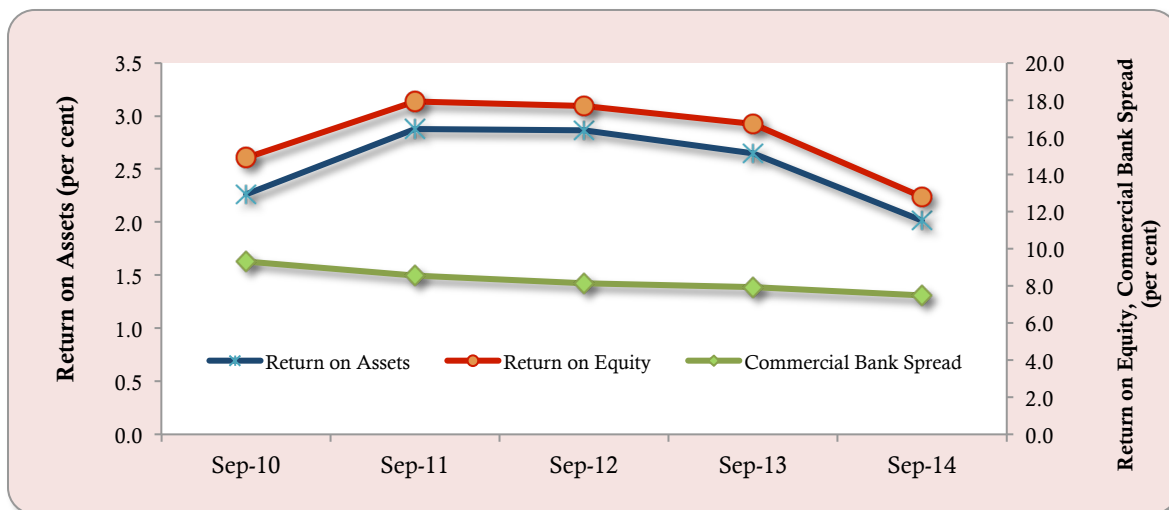
Figure 2
Banking System Capital Adequacy Ratios, September 2010 – September 2014



Source: Central Bank of Trinidad and Tobago.

The banking system continued to experience slower income growth and reduced profitability in 2014 as the low interest rate environment partly induced a further narrowing of spreads and depressed income from investments. An expansion in lending to the private sector was not strong enough to offset the effect of lower interest income, resulting in banks increasing fee income, mainly service charges. Notwithstanding a decline in interest expenses, higher operating costs in 2014 eroded overall profitability ratios in the banking system (Figure 3). Return on equity fell from around 18 per cent in September 2011 to almost 13 per cent in September 2014, while return on assets declined to 2 per cent from just under 3 per cent over the same period.

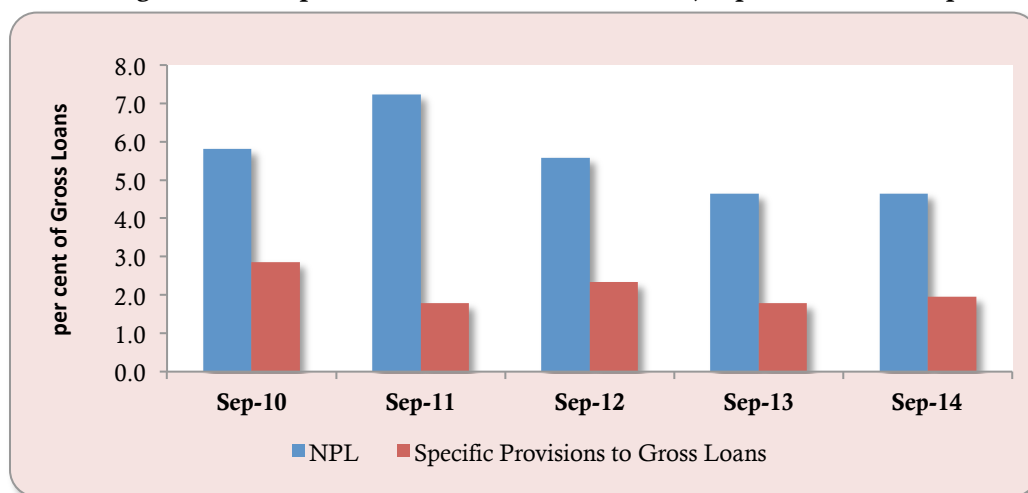
Figure 3
Banking System Selected Profitability Indicators, September 2010 - September 2014



Source: Central Bank of Trinidad and Tobago.

Asset quality in the banking system improved further with non-performing loans falling to around 4½ per cent of total loans by September 2014, continuing the downward trend started in 2011 when non-performing loans peaked at 7 per cent (Figure 4). The improvement in credit quality resulted from banks undertaking a combination of loan restructuring, stronger collection efforts and loan write-offs primarily in commercial real estate.

Figure 4
Non-Performing Loans and Specific Provisions to Gross Loans, September 2010 – September 2014



Source: Central Bank of Trinidad and Tobago.

Furthermore, the credit quality of banks' investment assets remained high as holdings were concentrated in low-risk government securities. As at September 2014, treasury bills and

government bonds accounted for 53 per cent and 41 per cent, respectively, of total local investments while equity securities, corporate bonds and mutual funds made up most of the remaining 6 per cent. Investments in foreign assets which constituted approximately 30 per cent of the banking system's investment portfolio were mainly in low risk US treasury bills, although higher risk corporate bonds also represented a significant share at 30 per cent.

Persistent high levels of liquidity in the domestic financial system kept funding risks low for commercial banks and non-bank financial institutions in 2014. Liquid assets constituted a little over 25 per cent of total assets on their combined balance sheets. On the foreign currency side, foreign currency deposits declined by around 6½ per cent in 2013 after growing by more than 20 per cent in 2012. Further, the ratio of foreign currency liabilities to total liabilities fell by less than 2 percentage points to approximately 25 per cent.

INSURANCE SECTOR

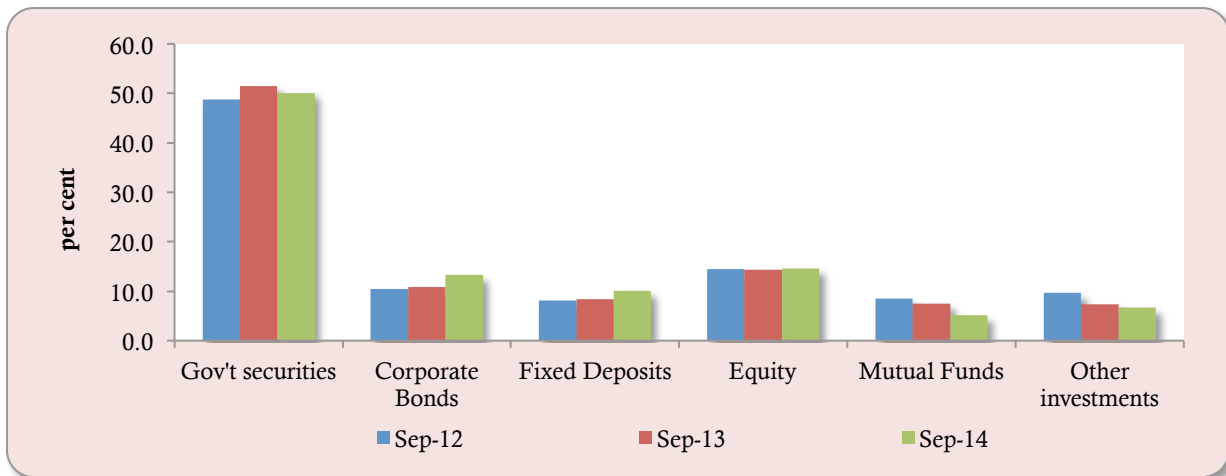
The insurance industry is an important part of the domestic economy by virtue of both its size and its critical role in the mitigation of business and personal risks. While limited investment opportunities and risky sovereign debt exposures within the region have posed some challenges for insurance companies, the industry continues to be relatively stable.

Life Insurance Industry¹

Life insurance companies account for almost 80 per cent of the industry's assets. Over the year to September 2014, life insurance assets increased by over 7 per cent to around \$21 billion. Government securities remained the dominant asset class in the investment portfolios of life insurance companies (Figure 5). In recent years, some life insurance companies have become increasingly involved in offering non-traditional unit-linked products and individual annuities, often with minimum-rate guarantees and higher rates of return relative to bank deposits. This makes these non-traditional, insurance products more attractive to policyholders but also exposes the life insurance industry more to market risk. At the end of September 2014, non-traditional products accounted for close to 60 per cent of total insurance liabilities. Strong demand for unit-linked products and individual annuities drove the robust growth of almost 14 per cent in gross premium income over the year to September 2014.

¹ This section excludes information on CLICO which is under the control of the Central Bank under Section 44D of the Central Bank Act.

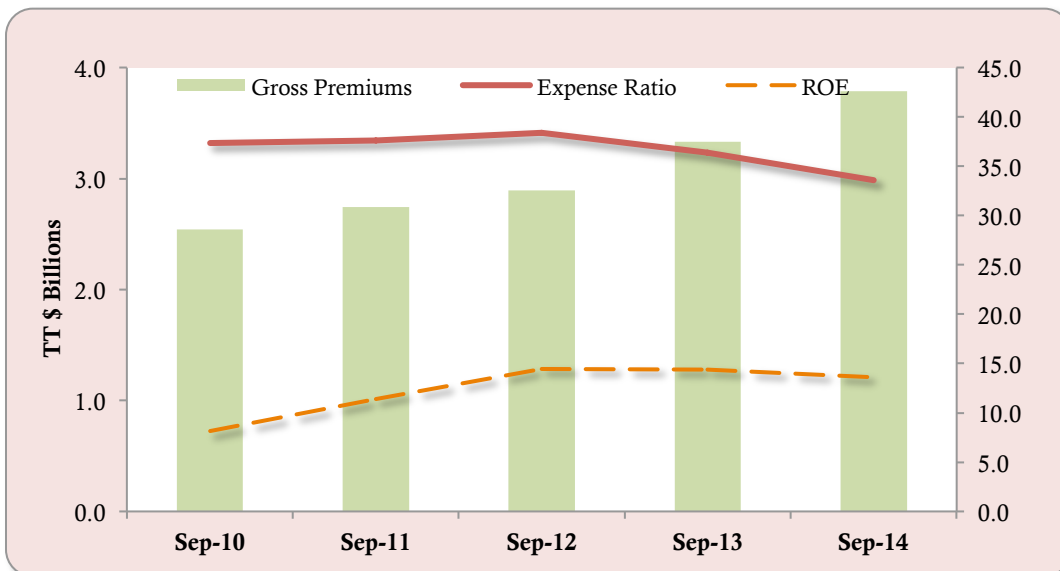
Figure 5
Life Insurance Companies: Investment Structure, September 2012 – September 2014



Source: Central Bank of Trinidad and Tobago.

Despite the dampening effect of low interest rates on investment yields, reported profits in the life insurance sector have remained relatively stable over the past few years. Premium growth has exceeded the growth in expenses thereby driving down the expense ratio to about 35 per cent in September 2014, the lowest level in five years (Figure 6).

Figure 6
Life Insurance Companies: Gross Premiums, Expense Ratio and Return on Equity, September 2010 to September 2014



Source: Central Bank of Trinidad and Tobago.

Non-Life Insurance Industry

Premium income accruing to non-life companies grew by almost 9 per cent to \$3.8 billion in the year to September 2014 (Table 3).

Table 3
Non-Life Insurance Companies: Distribution of Gross Premium Income,
September 2010 – September 2014

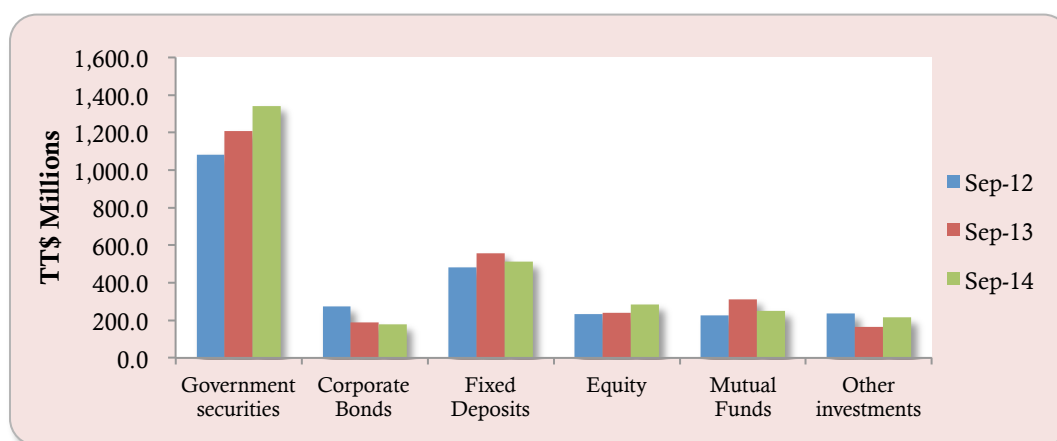
	Sep-10	Sep-11	Sep-12	Sep-13	Sep-14
	/TT\$ Millions/				
Property	1,351.5	1,419.2	1,636.6	1,632.9	1,813.5
Motor Vehicle	1,174.6	1,179.0	1,206.4	1,257.6	1,378.4
Group Health	118.3	108.1	133.8	142.5	112.5
Other	463.2	448.7	495.0	522.3	566.6
Total	3,107.5	3,155.0	3,471.8	3,555.4	3,870.9

Source: Central Bank of Trinidad and Tobago.

This was mainly due to acceleration in premium revenue from property and motor vehicle insurance which more than offset relatively lower income in the group health segment. The decline in group health business was primarily due to the transfer of health business from one non-life insurer to a life insurer within the market. Property insurance dominates the non-life sector accounting for about 50 per cent of total premiums. However, it is heavily reinsured with about 93 per cent ceded to international insurers.

The investment structure of non-life insurance companies is similar to that of the life sector, where government securities represent about 50 per cent of the total investment portfolio (Figure 7).

Figure 7
Non-Life Insurance Companies: Investment Structure, 2010 – September 2014



Source: Central Bank of Trinidad and Tobago.

While most non-life companies continue to make steady profits, some institutions posted underwriting losses over the last twelve months to September 2014. This coupled with falling investment yields resulted in a decline in profitability for the non-life sector.

PRIVATE OCCUPATIONAL PENSION PLANS

The total estimated value of the assets under management for all private occupational pension plans stood at \$47.5 billion as at September 2014. Data from the three largest corporate trustees showed that nearly 45 per cent of pension assets under management were held in equities.

Actuarial valuation reports for the triennial period 2011 to 2013 indicated pension plans have been experiencing declining funding levels mainly due to the continued low interest rate environment (Table 4). Pension plans funding levels, measured as the ratio of assets to liabilities calculated by the Plan's Actuary, fell to 122 per cent in 2011-2013, from 135 per cent in 2008-2010.

Table 4
Results of Actuarial Valuation Reports, 2008-2010 and 2011-2013

NUMBER OF PENSION PLANS	137	
Valuation Dates	2008-2010	2011-2013
Total Membership	64,686	70,788
Total Assets (\$ billion)	\$25.9	\$31.0
Total Liabilities (\$ billion)	\$18.8	\$26.3
Average Funding Level	135 %	122 %

Source: Central Bank of Trinidad and Tobago.

Pension plans remain vulnerable to a number of risks in the prevailing low interest rate environment. Reduced cash inflows negatively affect the ability of plans to meet long term obligations, as more cash is diverted away from investment and used to pay current pension benefits. Declining funding levels mean that Trustees and Plan Sponsors have to be increasingly vigilant to ensure pension plans are able to fully pay benefits as they become due. For pension plans which are either in deficit, that is, where liabilities exceed the assets and the funding level is below 100 per cent, or those with a small surplus, the actuaries have been recommending increased contributions to secure retirement benefits.

BOX 1

The New Insurance Bill 2013

A modern and efficient legislative framework is an essential tool for enabling Central Bank to fulfill its objectives of promoting financial stability and protecting the rights of policyholders. The new Insurance Bill (IA Bill 2013) is an attempt to modernize the legislative and regulatory framework to effectively monitor the insurance industry.

The Bill introduces significant improvements in the following technical areas:

Risk-Based Capital: Under the proposed legislation, an insurer will be required to hold, in addition to the new minimum capital (\$15 million for long-term or general insurance and \$22.5 million for composites) substantially higher levels of capital commensurate with its risk profile. Every insurer will be required to maintain a regulatory capital ratio (available capital to required capital) of at least 150 per cent.

In order to understand the quantitative effect of this proposed measure, the Central Bank conducted a number of impact studies during the developmental stage of this framework. As a general observation, the life insurance sector is better capitalized than the general insurance sector. Although many companies will meet and exceed the new requirements, there are some notable exceptions. The new legislation will allow a transition period to give companies time to achieve compliance with the new capital standards.

Actuarial Valuation Methodology: Current legislation does not define a common approach or methodology for valuing a company's obligations to its policyholders. This has resulted in a variety of approaches being used throughout the sector. To address this, the proposed insurance legislation introduces the Caribbean Policy Premium Methodology (CPPM) as a standardized methodology for the valuation of liabilities for long-term insurers. This methodology is also endorsed by the Caribbean Actuarial Association (CAA) and its reporting format forms part of the CAA's standards of practice. For many companies, the adoption of a new methodology required some retooling of personnel and system reengineering. Central Bank has conducted a number of awareness and technical training sessions to fully apprise stakeholders of the requirements.

Financial Condition Reports: Following the global financial crisis, many corporations worldwide enhanced their enterprise risk management frameworks and now fully understand the need to test the robustness of their respective balance sheets. Although many large insurance companies have been incorporating stress testing as part of their risk management frameworks for many years, the same cannot be said for the rest of the industry. The new insurance legislation will require companies to perform a number of scenario tests that will stress their balance sheets to determine their resilience. The Financial Condition Report (FCR) generated from this exercise will be a required part of companies' internal risk management.

Administrative Fines/Penalties: The new Insurance Bill will also give the Inspector of Financial Institutions the power to administer civil money penalties against a registrant for clear breaches of the legislation. This is a material change from the current regime in which all breaches of the legislation are subject to criminal penalty enforceable only on summary conviction.

In addition to the above, the new insurance legislation enhances many of the provisions in the current law to ensure consistency among the major pieces of legislation that govern the financial sector, namely (Financial Institution Act (2008), Securities Act (2012)).

CHAPTER THREE: LOAN-TO-VALUE RATIO AS A MACROPRUDENTIAL POLICY TOOL

Real estate boom-bust cycles can threaten financial stability. The bursting of the United States residential real estate bubble triggered the current global financial crisis. While bubbles, that is, price misalignments relative to economic fundamentals, still remain difficult to spot with certainty, the task can be made easier by focusing on sharp increases in credit and leverage of households and financial institutions which, after all, are the true sources of vulnerabilities.

Central banks and supervisory authorities across the world are now placing much more emphasis on pre-emptive policy actions that could either alleviate real estate bubbles, or at least contain the potential damage to the financial sector and the broader economy. There is a growing consensus that macroprudential policy is a better option to more directly deal with risks associated with real estate booms and busts and at a lower cost than either monetary or fiscal policy.

In the macroprudential policy toolkit, the loan-to-value (LTV) ratio - the ratio of the maximum permitted loan against the value of the property - has emerged as the main instrument for reducing systemic risk generated by boom-and-bust cycles in property markets.

Containing leverage through a LTV limit reduces risks associated with sharp declines in house prices. The lower the leverage, the greater the drop in house prices needed to fall below the nominal value of loans and put households into negative equity. In turn, this will likely result in fewer defaults if a bust comes, as more borrowers unable to repay their mortgages will be able to sell their houses. In addition, in case of default, banks will be able to obtain higher recovery ratios. On the macro front, the LTV limit reduces the risk that a large sector of the real economy ends up with a severe debt overhang.

Asian countries were the forerunners in use of the LTV policy and made use of this tool to deal with overheating in their housing markets long before the recent financial crisis. Post-crisis, central banks in Norway, Sweden and Finland introduced various forms of limits on LTV ratios for new residential mortgage lending. In October 2014, the Bank of England obtained legal powers to more swiftly implement LTV ratios on mortgages. Nevertheless, the LTV policy framework is still in its infancy and this measure has often been used in combination with other housing market interventions, making it difficult to attribute outcomes to specific tools.

In Trinidad and Tobago, the mortgage market fulfills a critical role in supporting the country's housing market. Owning a home is often a significant milestone in a person's life and, in some cases, property expenditure is the single largest item of spending for households, with homes typically financed by long term variable rate mortgages. The mortgage market can pose threats to financial stability via two channels.

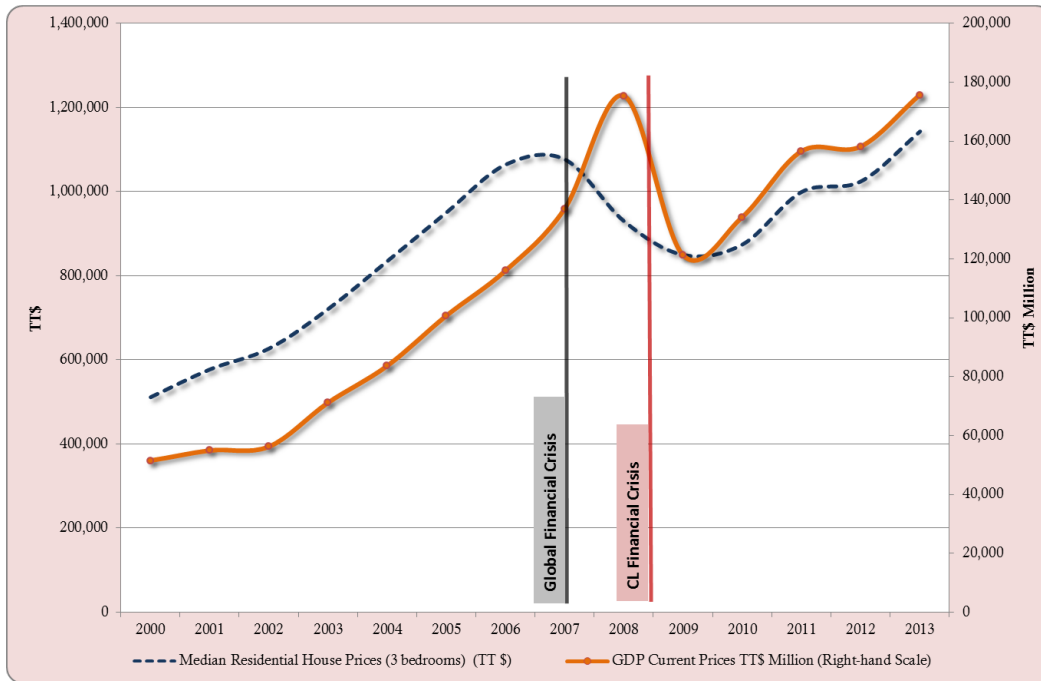
First, mortgages are the single *largest asset class* on the balance sheets of banks. In 2014, mortgage lending represented more than 40 per cent of the loan portfolio of the domestic banking system. Increasing defaults on mortgage loans, especially when accompanied by large declines in the value of housing assets used as collateral, can significantly impair banks' capital positions.

Second, mortgages are the *single largest liability* on the balance sheets of households in Trinidad and Tobago. A fall in perceived housing wealth could therefore cause households to cut back on spending. In turn, this can weigh on economic activity, and may lead to losses on a wider set of assets on banks' balance sheets.

The housing market has a self-reinforcing loop linking credit and asset prices which can further amplify threats to financial stability. Housing is the main source of collateral in the economy. As house prices rise, households experience rising wealth and lenders see their collateral value grow. This can result in an increase in both demand for and supply of credit which feeds back into higher house prices. In a downturn, this amplification mechanism works in reverse and could seriously threaten banking stability if bank exposure to the property market is not properly managed.

Property prices in Trinidad and Tobago have historically exhibited strong cyclical patterns. The median price of a 3-bedroom house rose by over 400 per cent in 1991 to 2008. Property prices fell sharply in 2009-2010, partly due to the CLICO crisis which hit overall economic confidence, before rising again from around 2011. In 2013, the median price of a 3-bedroom house reached \$1.1 million, 35 per cent higher than in 2008 and more than double the median house price in 2000 (Figure 8). In 2014, house prices increased by around 9 per cent bringing the median price of a 3-bedroom house to \$1.3 million.

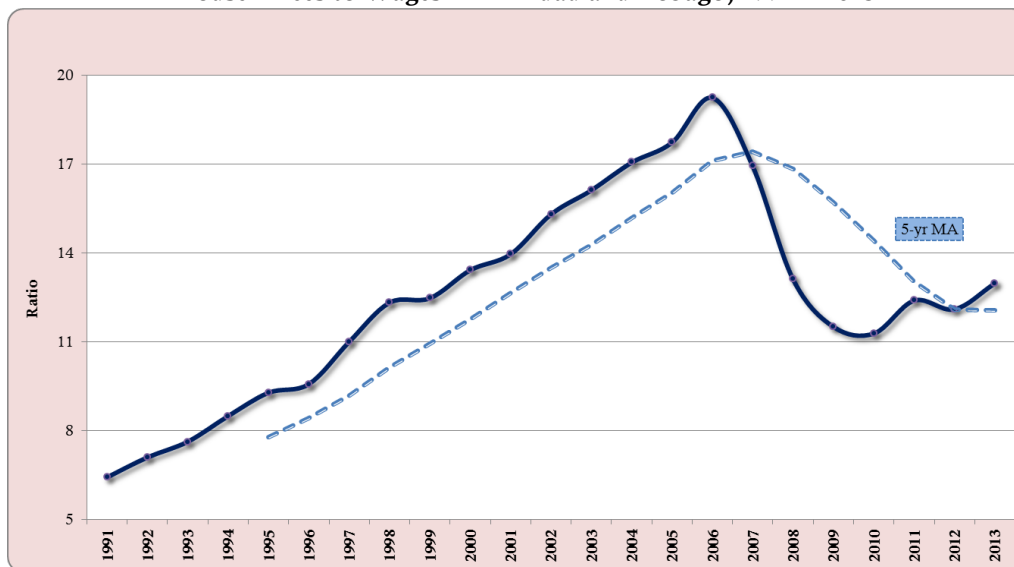
Figure 8
Trinidad and Tobago: House Prices versus Gross Domestic Product (2000-2013)



Source: Central Bank of Trinidad and Tobago.

The House-Price-to-Wages ratio (HPW) is one indicator that can be used to gauge the affordability of housing at current income levels (Figure 9). The HPW is measured as the median price of a three-bedroom house divided by average annual wages. House prices rose faster than average earnings from 1991 to 2006, suggesting house price affordability deteriorated in this period. The HPW fell during 2006-2009, suggesting some improvement in the affordability of housing. House prices once again began to outstrip the pace of growth in average annual wages during 2010-2013, leading to further deterioration in the ability of households to afford purchase of a new house.

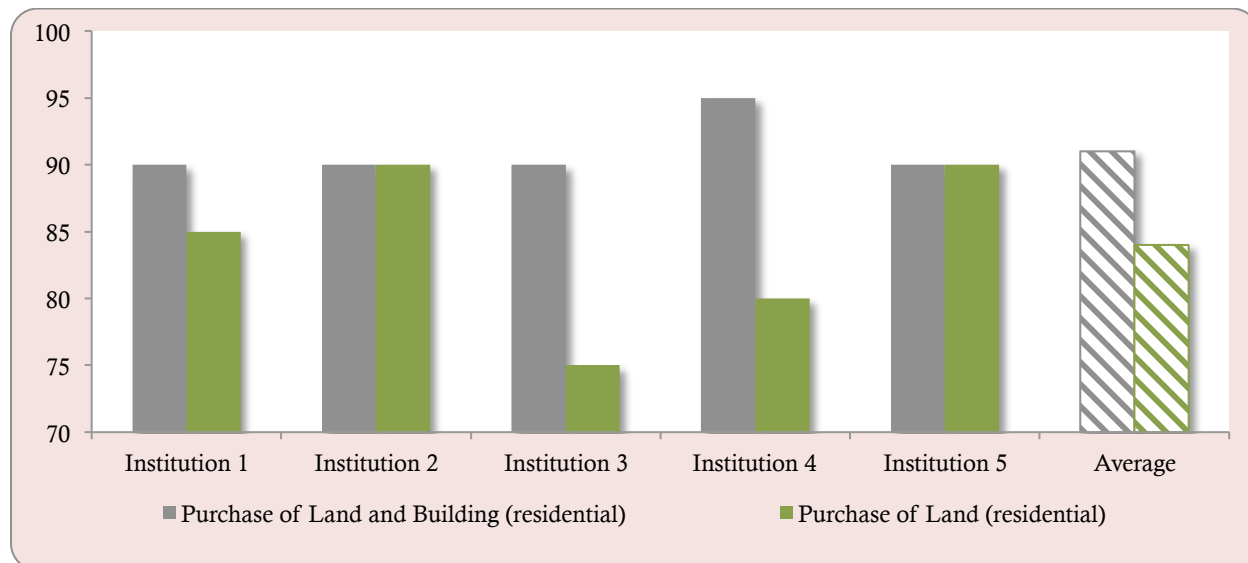
Figure 9
House Prices to Wages in Trinidad and Tobago, 1991 – 2013



Source: Central Bank of Trinidad and Tobago.

In Trinidad and Tobago, the LTV is used as a micro prudential measure. By definition, the LTV ratio imposes a minimum down payment on households relative to the price of the underlying collateral (Figure 10). Each major mortgage lending institution adopts its own credit policy and internal limits for LTV with an average LTV ratio of a little over 90 per cent for purchase of residential land and building and for just below 85 per cent for purchase of residential land only.

Figure 20
Loan-To-Value (LTV) Ratio applied on Residential Property by Institution in Trinidad & Tobago



Source: Central Bank of Trinidad and Tobago.

Table 5 summarizes LTV ratio decisions in sample of countries.

Table 5 Loan-To-Value Ratio Decisions

COUNTRY	USE OF LTV RATIO
Korea	LTV in effect since early 2000 and tightened four times and loosened once since 2002.
Hong Kong	Adjustments in LTV ratio in effect since the early 2000s and tightened together with introduction of mandatory mortgage insurance.
Singapore	LTV in effect since early 2000. In 2010, LTV caps reduced from 90% to 80% for all borrowers and reduced to 70% and later to 60% for borrowers with one or more outstanding housing loans. Non-individual buyers faced an LTV ratio of 50%.
Sweden	Introduction of maximum LTV ratio of 85% for mortgages in 2010.
Canada	Introduced 0% down-payment and 30 years amortization on loans in 2006. In October 2008, minimum down-payment requirements for insured loans increased from 0 to 5%, the maximum LTV for insured loans reduced from 100% to 95% and 85% on refinancing loans and loans to purchase property. Maturity of mortgages with more than 80% LTV capped at 25 years and mandatory insurance for high LTV loans.
New Zealand	LTV restrictions took effect October 1, 2013. Tiered LTVs (speed limits and outright limits) allow banks to cater to all type of borrowers.
Indonesia	Imposed lower LTV ratios on 2 nd and 3 rd mortgages to curb loan growth & property speculation (September 2013).
Netherlands	Imposed 1 per cent point annual reduction in LTV ratio cap on new mortgage loans to 100 per cent by 2018 (2013).
Finland	In March 2010, the authorities recommended (not binding) a maximum LTV ratio of 90% and maximum 25 years of amortization in calculation of mortgage affordability.
Norway	In March 2010, LTV limit set at 90% (not a hard cap) where LTVs on home equity loans should generally not exceed 75%. In December 2011, LTV set at 85%, lowering the maximum LTV on home equity loans to 70%.
Turkey	In January 2011, residential mortgage loans LTV set at 75%, mortgages on commercial real estate properties limited to LTV of 50%.
China	In April 2001, maximum LTV ratios for mortgages reduced to 80%. In March 2005, LTV ratio set at 70% for properties in cities or regions with excessively fast housing price increase (decision up to banks). In June 2006, maximum LTV ratio reduced from 80% to 70% for housing larger than 90m ² excluding purchases for own use by individuals. In September 2007, LTVs lowered to 60% for second mortgage loans but required minimum down payment ratio higher for third mortgage loans. In October 2008, LTV raised to 80%. In Apr 2010, the LTV on primary homes lowered from 80% to 70% for the first home buyers of apartments over 90 m ² and to 50% on second homes. In September 2010, the LTV ceiling lowered to 70% for all first home buyers. In January 2011, the LTV cap lowered to 40% for mortgages of second homes. In Mar 2013 (announced), LTV for mortgages of second homes were lowered.
Malaysia	In Nov 2010, maximum 70% LTV limit placed on the 3rd outstanding housing loan. In Dec 2011, residential property loans taken by non-individual borrowers also subjected to an LTV ratio of 60%.

Source: Central Bank of Trinidad and Tobago.

The decision whether or not to apply the LTV tool in Trinidad and Tobago is necessarily context dependent. However, some relevant considerations can be identified to help guide such a decision. These are as follows:

- *Stand-alone tool or a set of instruments:* In some countries, the LTV tool is used as a single instrument to address systemic risks generated from fluctuations in the housing market. In other countries, alongside the LTV tool, the debt-to-income measure is used, as both complement each other, in reducing the cyclical nature of the property market. A few countries use a combination of macroprudential instruments to keep mortgage lending under control. Apart from LTV limits, these include a core funding ratio, a countercyclical capital buffer and sector-specific capital requirements. Using a combination of macroprudential instruments gives a greater assurance of tackling property price risks from varying angles but it implies higher regulatory and administrative costs for enforcement.
- *Rules-based or discretionary measure:* A rules-based approach to macroprudential measures may be less risky than a discretionary approach. However, in the case of the LTV ratio, the short historical experience indicates it may be helpful to adjust the LTV across the housing cycle at discretion of the policymaker. Such adjustments should be clearly articulated to the public and be based on sound principles.
- *Transparency and accountability:* The LTV ratio is easily understandable to the public and acts to maximize transparency and signaling effects. It can flag serious regulatory concern regarding developments in the housing market and help avoid borrowers being pushed into negative equity. Calibration may be challenging. Certain segments of the population such as low-income and first-time home buyers may be unable to access a mortgage if they fail to comply with the LTV criteria. Therefore, implementation of LTV limits carries reputational risk.
- *Effectiveness:* In many countries where the LTV tool has been implemented, it has been self-assessed as effective in reducing credit growth and asset price inflation. However, LTV limits were not effective in addressing excessive leverage. In addition, the LTV tool has only become very popular post the global financial crisis so it may be too early to tell its true effectiveness in dampening credit growth and house price appreciation.
- *Efficiency:* LTV limits come with efficiency costs, as they can screen out both “good” and “bad” borrowers. If LTV limits are introduced in isolation from other lending standards, they can screen out “good” borrowers who have little equity but may have strong capacity to repay the mortgage. Conversely, LTV limits may allow “bad” borrowers who have the initial equity but would not be able to service the mortgage over its full term. Consideration can be given to targeted LTV ratios for specific sectors where housing credit growth may be deemed excessive.

- *Gaming the System:* Banks might choose to “game” the restrictions by reclassifying loans so they are not affected. Banks may also decide to lend secured up to the LTV cap and extend some form of unsecured security for the difference above the LTV limit.
- *Broad based or targeted:* Some countries apply macroprudential instruments broadly without very little differentiation while other countries may establish specific tools for meeting specific objectives. In most cases, the cap on the LTV ratio is typically found through trial and error, with countries starting with a threshold and then adjusting up and down to obtain the suitable setting. In some countries with targeted limits, the differentiation is based on borrower type (owner-occupied, bought for investment, first-time home owner and refinance) and property type (location and value).

Like many other policymaking decisions, the correct policy response to real estate booms is more art than a science. Macroprudential measures such as LTV ratios appear to be better policy options to curb sudden and rapid increases in real estate prices and excess leverage because of their ability to deal with the problem at its source, their adaptability to be tailored to country specific circumstances, and their added benefit of helping to improve resilience of the banking system. Calibration of macroprudential tools will be a learning process for central banks which will need to craft clear communication strategies to build and deepen public awareness of these emerging policy instruments.

CHAPTER FOUR: STRENGTHENING THE FINANCIAL SYSTEM ARCHITECTURE

Financial regulation and supervision are aimed at promoting stability and efficiency in the financial system and involve monitoring and examining the condition of financial institutions and their compliance with applicable legislation. In the wake of the CLICO crisis, Central Bank has intensified its efforts and is now closely monitoring institutions that have the potential to significantly disrupt the functioning of the financial system and the economy. At the same time, Central Bank collaborated with other supervisory authorities to prepare for the country's fourth-round Mutual Evaluation which took place in January 2015. The Mutual Evaluation assessed the country's compliance with the Financial Action Task Force's recommendations on Anti-Money Laundering and Combatting the Financing of Terrorism.

REGULATION OF SYSTEMICALLY IMPORTANT FINANCIAL INSTITUTIONS

Of the many lessons learnt from the 2008 global economic crisis, the significance of interconnections within and between a country's financial systems and the need for greater emphasis on the supervision and regulation of Systemically Important Financial Institutions (SIFIs) was highlighted. Central Bank is of the view the oversight of SIFIs is imperative given that the failure of any of these institutions can threaten the smooth functioning of local financial markets and the economy and have socio economic implications. In November 2009, the G20 Finance Ministers agreed on three main criteria for the identification of SIFIs as proposed by the International Monetary Fund, Bank for International Settlements and the Financial Stability Board:

1. **Size:** measuring the volume of financial services provided by an institution or group.
2. **Lack of substitutability:** assessing the financial system's relative dependence on the financial services provided by a single entity.
3. **Interconnectedness:** looking at the direct and indirect links between financial institutions that can contribute to the spread of systemic risk and its transmission to the real economy.

These criteria in conjunction with ancillary indicators of systemic significance were utilized by Central Bank in determining which domestic financial institutions not currently under its

regulatory purview should be classified as systemically important. Accordingly, five (5) entities were designated as SIFIs in the Trinidad and Tobago context:

1. The Home Mortgage Bank (HMB);
2. The Unit Trust Corporation of Trinidad and Tobago (UTC);
3. The Board of Management incorporated under the National Insurance Act (NIB);
4. The Trinidad and Tobago Mortgage Finance Company Limited (TTMF) and
5. The Agricultural Development Bank of Trinidad and Tobago (ADB)

These institutions will continue to comply with their existing statutes in the short term and additionally will be subject to a robust supervisory regime focusing on capital and liquidity requirements, frequent reporting to the Central Bank, enhanced corporate governance requirements and regular and focused stress testing.

In addition, four (4) commercial banks and two (2) life insurance companies have been designated as SIFIs:

(a) Commercial Banks

1. Scotiabank Trinidad and Tobago
2. RBC Royal Bank (Trinidad and Tobago) Limited
3. First Citizens Trinidad and Tobago
4. Republic Bank Limited

(b) Insurance Companies

1. Guardian Life of the Caribbean Limited
2. Sagicor Life Inc. (Trinidad and Tobago)

These institutions, which are already regulated and supervised by Central Bank, will be subject to additional requirements specific to their designation. The requirements will emphasize capital, enhanced engagement and reporting, strengthening of cooperation with other domestic and regional regulators and the development of appropriate resolution and recovery plans.

Central Bank is currently developing a risk-based supervisory framework for SIFIs, based on their respective business models and risk profiles. The on-boarding process has already begun with the UTC, the TTMF and the ADB through:

- a) Business Model analysis
- b) Onsite Examinations and
- c) Definition of Supervisory Intensity based on their risk profile

Engagement with the remaining two SIFIs has commenced with further activity planned in the second quarter of 2015.

ANTI-MONEY LAUNDERING AND COMBATTING THE FINANCING OF TERRORISM (AML/CFT)

Third Round Mutual Evaluation

In 2005, Trinidad and Tobago underwent a Third Round Mutual Evaluation to assess its compliance with the Financial Action Task Force's (FATF) forty (40) Recommendations on Anti-Money Laundering (AML) and nine (9) Special Recommendations on Combatting the Financing of Terrorism (CFT). The Mutual Evaluation Report (MER) found Trinidad and Tobago was partially compliant or non-compliant with fifteen (15) of the sixteen (16) Core and Key Recommendations and twenty-six (26) other Recommendations.

Legislative Developments

Subsequently, the authorities in Trinidad and Tobago have enacted a slew of legislation in an effort to achieve compliance with the FATF 40 + 9 Recommendations on AML/CFT and cure identified deficiencies.

In December 2008, a new Financial Institutions Act (FIA) was enacted and the Insurance Act (IA) was also amended in 2009 to allow for *inter*

alia, sharing of information and enhanced enforcement powers for the Central Bank. A new Securities Act was enacted in 2012 which gave the Trinidad and Tobago Securities and Exchange Commission (TTSEC) the ability to conduct on-site examinations and strengthened its enforcement powers.

Trinidad and Tobago has made significant progress in remedying the deficiencies identified in the Third Round MER. The 10th Follow-up Report in May 2014 noted that Trinidad and Tobago is now fully compliant with eight Core and Key Recommendations and largely or partially compliant with the remaining recommendations. While this is a significant improvement, Trinidad and Tobago is mandated to rectify all its third round deficiencies by November 2014. In this regard, amendments have been made to the AML/CFT legislative framework to position the country to achieve substantial technical compliance with the revised FATF Standards.

Legislative Amendments, 2005-2013

- The Anti-Terrorism Act 2005 (ATA)
- The Proceeds of Crime (Amendment) Act, 2009 (POCAA)
- The Financial Intelligence Unit of T&T Act, 2009 (FIUTTA)
- The Financial Obligations Regulations, 2009 (FOR)
- The Anti-Terrorism (Amendment) Act, 2010 (ATAA)
- The Financial Intelligence Unit of T&T (Amendment) Act No.3 of 2011
- The Financial Intelligence Unit of T&T Regulations, 2011
- The Financial Obligations (Financing of Terrorism) Regulations, 2011
- The Financial Intelligence Unit of T&T (Amendment) Act No. 8 of 2011
- The Anti-Terrorism (Amendment) Act, 2011
- Trafficking in Persons Act (TPA)
- The Miscellaneous Provisions (Financial Intelligence Unit of T&T and Anti-Terrorism) Act, 2012

Fourth Round Mutual Evaluation

In January 2015, Trinidad and Tobago underwent a Fourth Round Mutual Evaluation that tested compliance with the FATF's Revised 40 Recommendations on AML/CFT. A key innovation in the revised FATF Standards and Methodology is an effectiveness component that assessed the adequacy of implementation of a country's AML/CFT framework based on certain outcomes.

Trinidad and Tobago was required to demonstrate the effectiveness of its AML/CFT regime by producing, *inter alia*, evidence or statistics on:

- number of on-site examinations of financial institutions and listed businesses;
- regulatory actions taken against financial institutions and listed businesses;
- number of suspicious activity reports (SARs) filed by listed businesses and financial institutions;
- number of SARs which led to prosecutions and/or convictions; and
- effectiveness of collaboration/cooperation among relevant national and international stakeholders in respect of AML/CFT.

Moreover, authorities in Trinidad and Tobago were required to demonstrate their awareness of key money laundering and terrorist financing risks and they are appropriately channeling resources to deal with these risks. To this end, Trinidad and Tobago with the assistance of the World Bank initiated a National Risk Assessment (NRA) in March 2014. The NRA identifies the country's major money laundering and terrorist financing threats, vulnerabilities and risks and sets out a plan to close any identified gaps.

Recent Initiatives to Enhance the AML/CFT Regime

An Inter-Ministerial Committee comprising the Attorney General, Minister of National Security and the Minister of Finance and the Economy was established in 2014 to coordinate activities of the multiple agencies engaged in the national AML/CFT compliance effort.

In the area of supervision, the Central Bank significantly increased the number of AML/CFT on-site examinations in 2014 to ensure adequacy of the AML/CFT compliance, monitoring and reporting systems of its regulated financial institutions.

Further, in recognition of the interconnectedness of financial institutions and the need for effective cooperation and collaboration with the other Supervisory Authorities, the Central Bank signed Memoranda of Understanding (MOUs) with the TTSEC and the FIU. The three Supervisory Authorities meet regularly and in 2013 collaborated with the Institute of

Chartered Accountants of Trinidad and Tobago (ICATT) to agree on a reporting format for AML/CFT reviews by external auditors.

In January 2014, the TTSEC established a new division of Compliance and Inspections to supplement the existing off-site surveillance of the securities sector. The FIU obtained membership in the Egmont Group in July 2013, which was a key milestone for the FIU, to enable information exchange and collaboration across national borders. All three Supervisory Authorities (Central Bank, TTSEC and FIU) have issued guidance notes to their regulated entities.

NATIONAL FINANCIAL CRISIS MANAGEMENT PLAN

A National Financial Crisis Management Plan for Trinidad and Tobago is under development and is one of the initiatives to strengthen the local financial stability infrastructure. The Plan seeks to provide the authorities with an effective regime to bring about an orderly resolution to a crisis faced by any of the financial institutions deemed systemically important and regulated by the Central Bank. Some key recommendations resulting from a review of the Plan by the IMF are being incorporated in terms of the consistency with other jurisdictions for resolution powers and a strategy for communicating with the public.

REGIONAL INTERCONNECTEDNESS: THE CARIBBEAN REGIONAL FINANCE PROJECT

The attainment of high financial integration in the region has posed several challenges for financial stability. Regional regulatory authorities have embarked on a project to strengthen the financial stability framework for cross-border operations and other forms of financial interconnectedness among the financial institutions in the major sectors. In this vein, development of a Financial Interconnectedness Map is underway to:

- Understand linkages among regional banks and insurance companies in order to measure their exposure to governments, other financial institutions and countries and sectors;
- Identify paths of vulnerability and potential contagion at aggregated levels; and
- Conduct stress testing at the national level of the linkages and vulnerabilities of individual systemically important financial institutions.

Regional regulators have distributed data templates to banks, building societies and insurance companies in their respective jurisdiction to collect specific data during the period July to October, 2014.

FOREIGN ACCOUNT TAX COMPLIANCE ACT (FATCA)

Foreign Account Tax Compliance Act (FATCA) is US tax legislation that requires financial institutions outside the United States to pass information about financial accounts held by US persons to the Inland Revenue Service of the United States (IRS). The Government of Trinidad and Tobago has chosen to enter into a Model One Inter-Governmental Agreement (IGA) with US authorities. This allows domestic financial institutions to report FATCA related information to the local tax authority, that is, the Board of Inland Revenue of Trinidad and Tobago (BIR). The BIR, in turn, will report the information to the IRS.

Work is underway to have the final IGA executed between Trinidad and Tobago and the US. Technical and legislative changes are being made to facilitate the information transfer required under FATCA. The financial sector plans to promote greater public awareness about the implications of FATCA to all stakeholders.

APPENDIX

TABLE A.1
COMMERCIAL BANKING SYSTEM STRESS TESTING RESULTS
September 2013 – September 2014

<i>Commercial Banking System Stress Testing Results</i> <i>/per cent/</i>		Sep-13	Dec-13	Mar-14	Jun-14	Sep-14	
	Pre-Shock CAR	24.1	23.1	23.7	23.0	23.4	
	Pre-Shock CAR Adjusted for Provisions	22.1	21.2	21.8	21.2	21.7	
Single Factor Tests							
		Post-Shock CAR				Post-Shock CAR	Change from Pre-Shock Adjusted CAR
Interest Rate Risk	Interest Rate ↑ 700 basis points	9.3	8.6	11.8	9.7	9.4	-12.3
	Interest Rate ↓ 100 basis points	23.8	22.8	23.2	22.7	23.3	1.6
Foreign Exchange Risk	TT Dollar depreciates 40 per cent	23.7	22.8	23.3	21.8	22.4	0.7
Credit Risk	GDP ↓ 20 per cent	20.3	19.4	19.8	19.4	19.8	-1.8
Credit Risk - Property Prices	Property Prices ↓ 30 per cent	20.2	19.3	19.8	19.3	19.7	-2.0
Scenario Tests							
		Post-Shock CAR				Post-Shock CAR	Change from Pre-Shock Adjusted CAR
Energy Price Shock	Price ↓ 50 per cent - No Policy Response	12.1	11.4	13.5	11.5	11.5	-10.2
	Price ↓ 50 per cent - Policy Response	23.6	22.7	22.7	21.5	22.2	0.5
Regional Disaster Scenario	Regional Natural Disaster	20.5	19.6	20.1	19.8	20.3	-1.4

Source: Central Bank of Trinidad and Tobago.

TABLE A.2
BANKING SYSTEM: FINANCIAL SOUNDNESS INDICATORS
September 2009 – September 2014

/per cent/

	Sep-09	Sep-10	Sep-11	Sep-12	Sep-13	Sep-14
Capital adequacy						
Regulatory capital to risk-weighted assets	23.2	24.6	27.5	26.4	25.5	25.6
Regulatory Tier I capital to risk-weighted assets	20.8	21.2	24.6	23.5	24.1	24.7
Regulatory Tier II capital-to-risk-weighted assets	2.4	3.4	2.9	2.9	1.4	0.8
Regulatory capital-to-total assets	13.5	13.9	14.1	14.1	13.2	13.1
Net Open position in foreign exchange-to-capital	5.1	3.5	10.0	8.7	11.1	6.1
Banking sector asset composition						
Sectoral distribution of loans-to-total loans						
Households	38.2	38.4	39.9	41.6	43.1	45.3
<i>of which:</i>						
Proportion secured as mortgage loans	30.3	37.8	38.9	41.3	41.5	42.1
Financial sector	20.1	19.7	18.4	17.7	15.0	15.0
Oil and gas sector	2.3	3.2	4.2	2.5	2.4	2.5
Construction	9.9	12.1	10.6	10.1	9.2	7.7
Transport and communication	2.5	1.8	1.8	2.9	4.0	3.2
Non-residents	7.8	6.5	5.6	5.4	4.4	3.8
Foreign currency loans-to-total loans	22.4	21.3	20.5	17.3	17.8	16.2
Banking sector asset quality						
Nonperforming loans-to-gross loans	3.4	5.8	7.2	5.6	4.6	4.6
Nonperforming loans (net of provisions)-to-capital	4.6	8.5	15.0	8.5	7.4	7.1
Total provisions-to-impaired loans*	62.4	54.6	31.3	50.5	48.5	53.2
Specific provisions-to-impaired loans	53.6	49.2	24.6	41.8	38.4	42.1
General provisions-to-gross loans*	0.3	0.3	0.5	0.5	0.5	0.5
Specific provisions-to-gross loans	1.8	2.9	1.8	2.3	1.8	2.0
Banking sector earnings and profitability						
Return on assets	2.8	2.3	2.9	2.9	2.6	2.0
Return on equity	18.7	14.9	17.9	17.7	16.7	12.8
Interest margin-to-gross income	66.1	64.3	60.4	61.1	60.7	57.0
Non-Interest income-to-gross income	33.9	35.7	39.6	38.9	39.3	43.0
Non-interest expenses-to-gross income	57.1	62.5	57.4	64.8	59.7	68.2
Banking sector liquidity						
Liquid assets-to-total assets	23.5	21.1	26.0	23.7	27.2	26.3
Liquid assets-to-total short-term liabilities	34.0	29.9	36.8	32.4	36.2	34.3
Customer deposits-to-total (non-interbank) loans	136.6	147.0	158.8	167.4	177.7	178.5
Foreign currency liabilities-to-total liabilities	36.6	29.7	29.6	27.4	26.3	24.9

Source: Central Bank of Trinidad and Tobago.

The banking system refers to commercial banks and non-bank financial institutions (NFIs) collectively.

All figures are weighted by assets.

End of Period except for Banking Sector Earnings and Profitability.

TABLE A.3
LIFE INSURANCE COMPANIES: FINANCIAL SOUNDNESS INDICATORS
September 2010 – September 2014
 /per cent/

	Sep-10	Sep-11	Sep-12	Sep-13	Sep-14
Capital Adequacy					
Capital to total assets	25.7	21.9	21.1	20.8	21.2
Capital / technical reserves	36.7	30.2	28.8	28.2	28.4
Asset Quality					
(Real estate +unquoted equities + debtors) / total assets	14.8	14.3	11.0	11.0	8.9
Earnings and Profitability					
Expense ratio = expense (incl commissions) /net premium	37.4	37.6	38.4	36.4	33.6
Investment yield = Investment income to investment assets	6.1	6.3	5.4	4.9	4.8
Return on Equity (ROE) = Pre-tax profits to shareholders funds	8.1	11.4	14.5	14.4	13.6
Liquidity					
Liquid assets to current liabilities	29.6	32.1	35.6	30.4	31.3

Source: Central Bank of Trinidad and Tobago.
 Note: Figures exclude data from Colonial Life Insurance Company (Trinidad) Limited and British American Insurance Company (Trinidad) Limited.

TABLE A.4
NON-LIFE INSURANCE COMPANIES: FINANCIAL SOUNDNESS INDICATORS
September 2010 – September 2014
 /per cent/

	Sep-10	Sep-11	Sep-12	Sep-13	Sep-14
Asset Quality					
(Real estate +unquoted equities + accounts receivables) / total assets	16.4	16.1	15.4	13.5	13.3
Debtors / (gross premiums + reinsurance recoveries)	10.6	11.9	11.5	10.7	10.0
Reinsurance and Actuarial Issues					
Risk Retention Ratio = Net premiums written/ total gross premiums	47.9	45.1	42.0	42.9	41.0
Net technical reserves/average of net claims paid in the last three years	130.3	149.8	164.3	168.9	172.6
Earnings and Profitability					
Combined Ratio	97.4	100.5	96.7	96.5	96.2
<i>Expense ratio = expense (incl commissions) /net premiums</i>	46.6	49.1	49.8	51.1	52.0
<i>Loss ratio = net claims/net earned premiums</i>	50.7	51.4	47.0	45.4	44.3
Investment income/net premium	6.7	8.4	8.4	7.9	8.6
Return on Equity (ROE) = Pre-tax profits to shareholders funds	18.6	11.3	17.9	18.6	15.9
Return on assets (ROA)	7.6	4.4	7.6	8.3	7.1
Liquidity					
Liquid assets to current liabilities	57.5	47.2	50.8	60.7	57.9

Source: Central Bank of Trinidad and Tobago.

ABBREVIATIONS

ADB	Agricultural Development Bank of Trinidad and Tobago
AML	Anti-Money Laundering
ATA	Anti-Terrorism Act
ATAA	Anti-Terrorism (Amendment) Act
BIR	Board of Inland Revenue of Trinidad and Tobago
CARICOM	Caribbean Community
CFT	Combatting the Financing of Terrorism
CLICO	Colonial Life Insurance Company
FATCA	Foreign Account Tax Compliance Act
FATF	Financial Action Task Force
Fed	Federal Reserve
FIU	Financial Intelligence Unit
FIUTTA	Financial Intelligence Unit of T&T Act
FOR	Financial Obligations Regulations
FY	Fiscal Year
GDP	Gross Domestic Product
HMB	Home Mortgage Bank
ICATT	Institute of Chartered Accountants of Trinidad and Tobago
IGA	Inter-Governmental Agreement
IRS	Inland Revenue Service of the United States
LNG	Liquefied Natural Gas
LTV	Loan-To-Value
MER	Mutual Evaluation Report
MOUs	Memoranda of Understanding
NIB	National Insurance Board
NRA	National Risk Assessment
POCAA	Proceeds of Crime (Amendment) Act
S&P	Standard and Poor
SARs	suspicious activity reports
SIFIs	Systemically Important Financial Institutions
TPA	Trafficking in Persons Act
TTMF	Trinidad and Tobago Mortgage Finance Company Limited
TTSEC	Trinidad and Tobago Securities and Exchange Commission
US	United States
UTC	Unit Trust Corporation of Trinidad and Tobago
WTI	West Texas Intermediate

