Implication of Basel 11 For The Development of a Regional Financial Centre

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April 28, 2006

Outline

- Nature of the Banking Industry in the Region
- Infrastructure needed for Basel 11 Implementation
- Potential impact of Basel 11 for the region
- The Way Forward

Nature of the Regional Banking Industry

- In the region, primary types of financial institutions:
  - Banks
  - Merchant banks
  - Trust companies
  - Finance houses

Nature of the Regional Banking Industry Cont'd

- Many regional financial institutions are branches or subsidiaries of int'l banks and this calls for the speedy implementation of Basel II
- As regulators, our focus is two-pronged:
  – Determining the risk profile of financial institutions
  – Ensuring institutions are comprehensively managing and mitigating risks

Nature of the Regional Banking Industry Cont'd

The Changing Risk profile of Financial Institutions

- Expansion of Group Structures
- More Complex Deal Making and Hybrid Products

Basic Infrastructure for Implementation of Basel 11

- **Before adopting Basle II, certain *pre-conditions* should exist:**
  - Compliance with Basel Core Principles (BCP’s)
  - Consolidated supervision of financial institutions
  - The adoption of the 1996 Market Risk Amendment
  - Amendments to Legislative & Supervisory frameworks to achieve full compliance with the above.

Basel Core Principles

- Powell (2004) shows that on average developing countries fully compliant with only 7 BCPs.

- Over 40% of developing countries are non-compliant or materially non-compliant with:

  (a) Connected Lending

  (b) Country Risk

  (c) Market Risk

  (d) Consolidated Supervision

Consolidated Supervision

- Consolidated supervision requires the strengthening of the supervisory frameworks and the upgrading of legislation.

- The latter is necessary to facilitate
  - (a) information sharing
  - (b) cross border supervision
  - (c) the restructuring of groups that are not supervisable.

1996 Market Risk Amendment

- Some jurisdictions have implemented the foreign exchange aspect of the 1996 Market risk amendments
- Collaborative work among jurisdictions is on-going

Upgrade of Legislation

- Amendments to legislation in the region are either in progress or recently concluded. (e.g. Trinidad & Tobago, Barbados, Jamaica)
- Development of a harmonized Financial Institutions Act for CARICOM member states

Potential Impact of Basel 11

- Use of the standardized approach to credit risk will be disadvantageous to Caribbean economies
- Most financial institutions/borrowers in the region are not rated by international ratings agencies
- Indigenous banks would be at a competitive disadvantage in attracting high-quality borrowers. These banks would therefore be holding large amounts of credit from unrated corporate borrowers, leading to higher capital requirements.
- Capital markets in the region are shallow.

Advantages of the New Framework

- The new Framework is more risk-sensitive
- Increased capital requirements provide greater safeguards for depositors
- Comprehensive framework for addressing credit, market and operational risk.
- Banks will have several options for determining capital requirements
- The new Framework encourages greater market discipline and transparency

Trinidad & **Tobago** Experience

- Domestic banks will most likely adopt the standardized approach while the internationally active ones will adopt the IRB approach.
- Implementation is projected to begin around 2009
- Central Bank is advanced in its plans for adopting the 1996 Market Risk Amendment
- Plans to conduct QIS are also in place

The Way Forward

- Continued regional discussion necessary
- Upgrading of human and technical resources
- Disclosure of key information on a continuous basis

Closing Remarks

- Develop international best practices, supervisory and regulatory standards
- Adhere to high corporate governance standards
- Enhance legislation and regulations
- Facilitate and encourage banks to improve their risk management capabilities

THANK YOU!