

Developing Comprehensive Supervisory Systems for Regionally Important Institutions



Assessing Macro-Prudential Vulnerabilities and Policy Frameworks in a Regional Context

Hosted by The Central Bank of Barbados (CBB)
and Caribbean Centre for Money and Finance (CCMF)

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CARTAC

Presentation Outline

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- What is a Systemically Important Financial Institution (SIFI)
- G-SIFIs
- R-SIFI - CLICO – Weaknesses / Lessons Learnt / Supervisory Framework
- FSB Policy Measures to address SIFIs
- Regional Interconnectedness and Concentration
- Supervisory Systems
 - Institutional arrangements
 - Effective legislation
 - Effective supervision
 - Resolution regimes
- CARTAC's Assistance

What is a SIFI?

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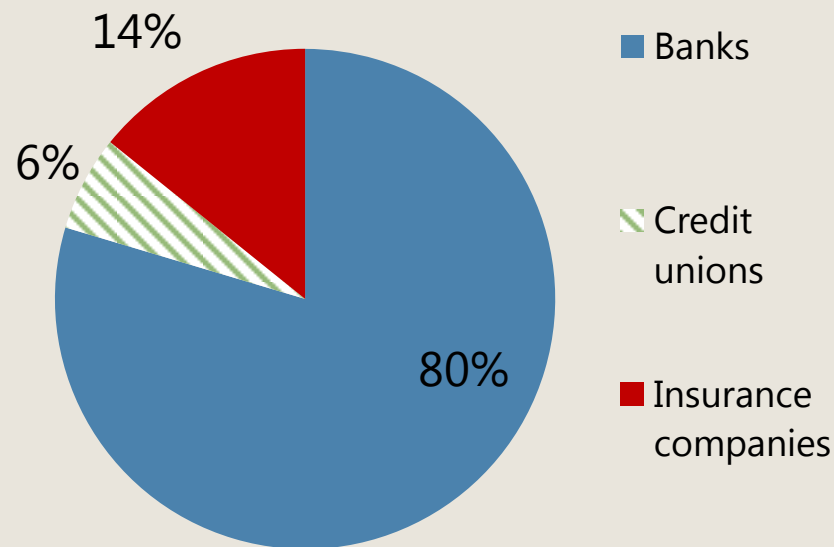
- “Systemically Important Financial Institutions (SIFIs) are **financial institutions** whose **distress or disorderly failure**, because of **their size, complexity and systemic interconnectedness**, would cause **significant disruption** to the wider financial system and economic activity”. FSB, Nov. 2012
- Size
- Complexity
- Interconnectedness

Structure of the Financial Sector



- The financial system of the Caribbean amounts to 1195% of the region's GDP, with offshore institutions accounting for 1080% and onshore banks 91%.
- Banks are major players in the onshore financial system.
- The Bahamas and Barbados have the largest financial sectors, with total assets 74 times and 12 times the size of their respective economies, owing mostly to massive offshore sectors.

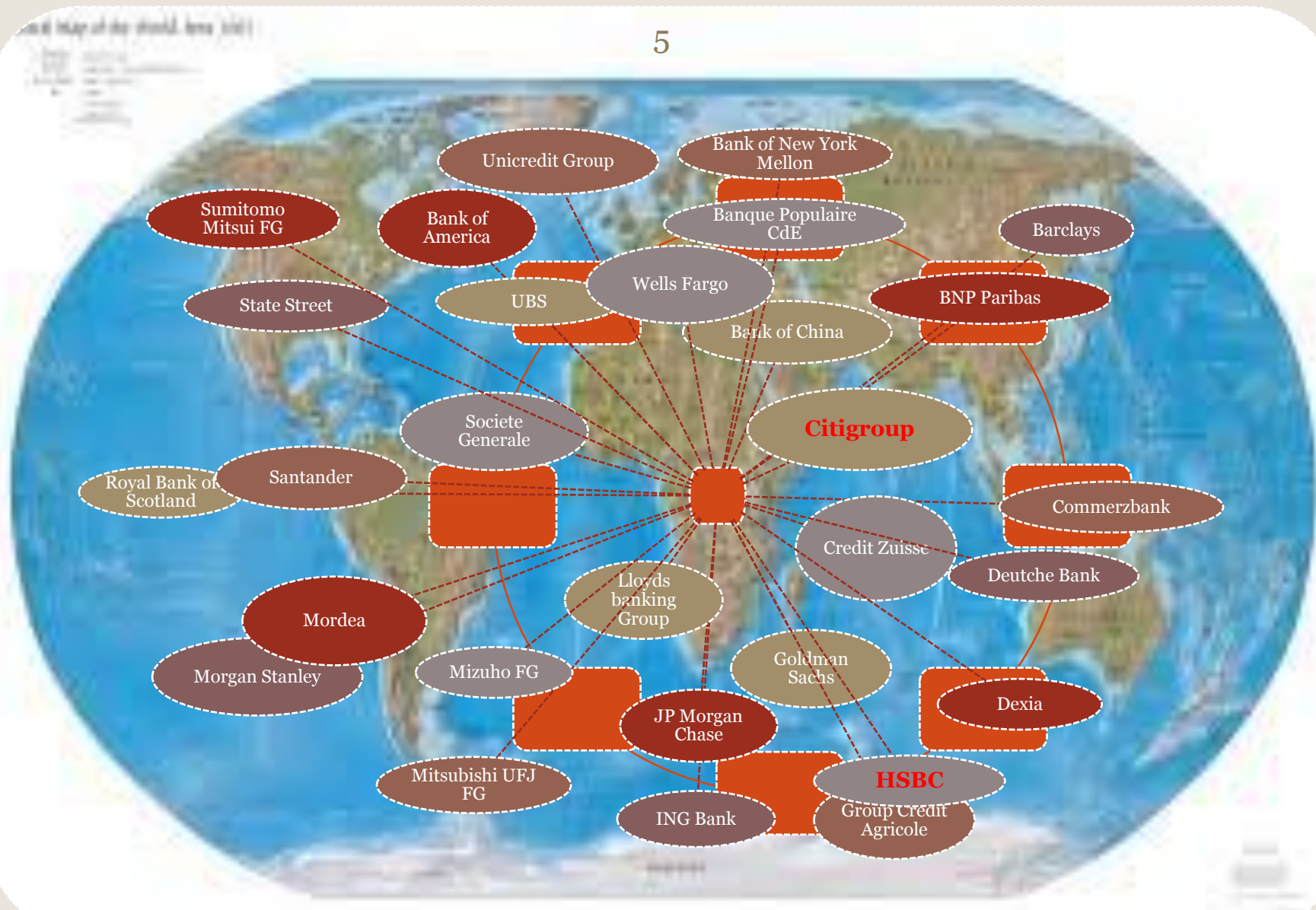
Assets of the Financial System
(In percent of total assets)



Sources: Each supervisory authority/Nita Thacker IMF 2012

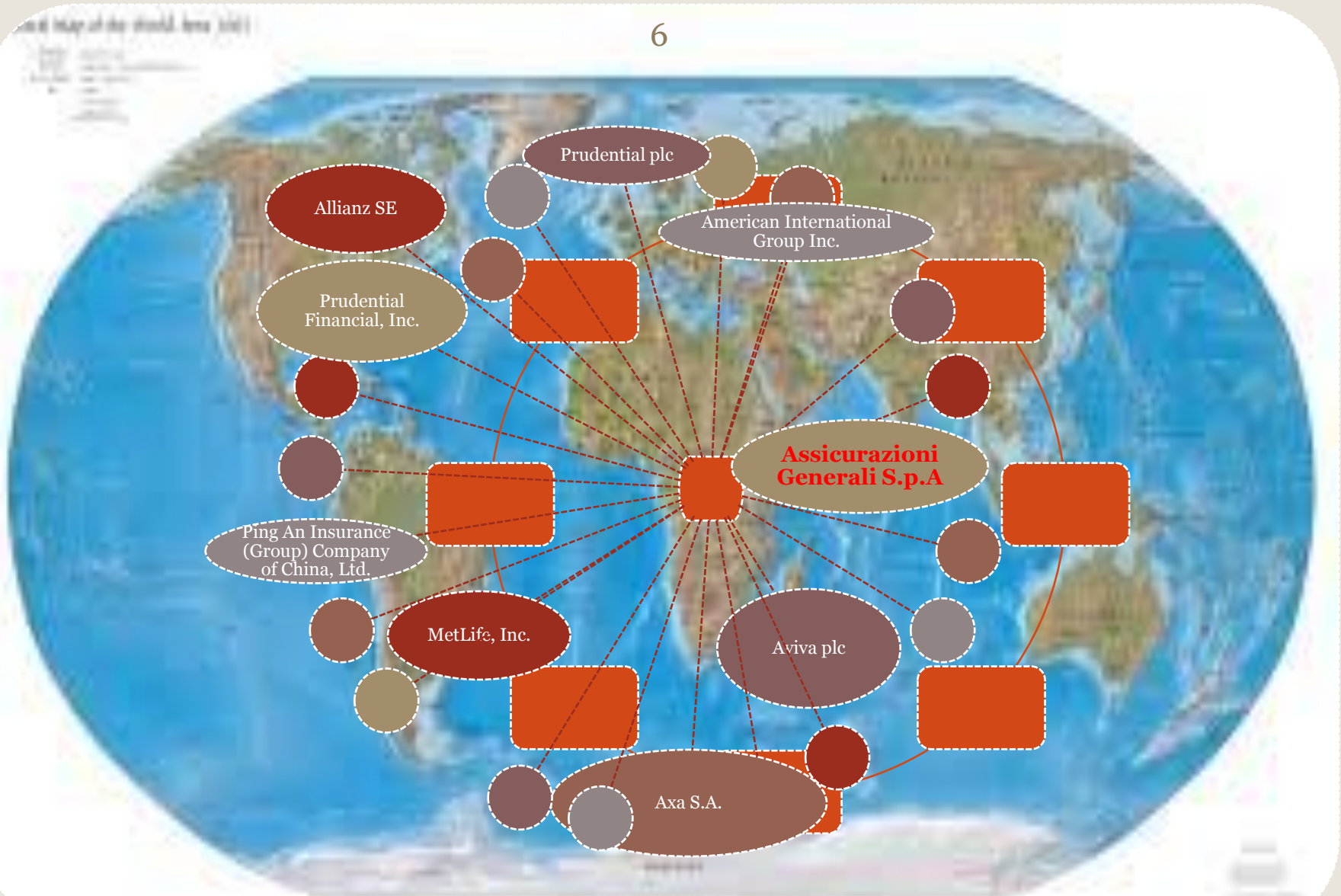
G-SIFIs - Banks

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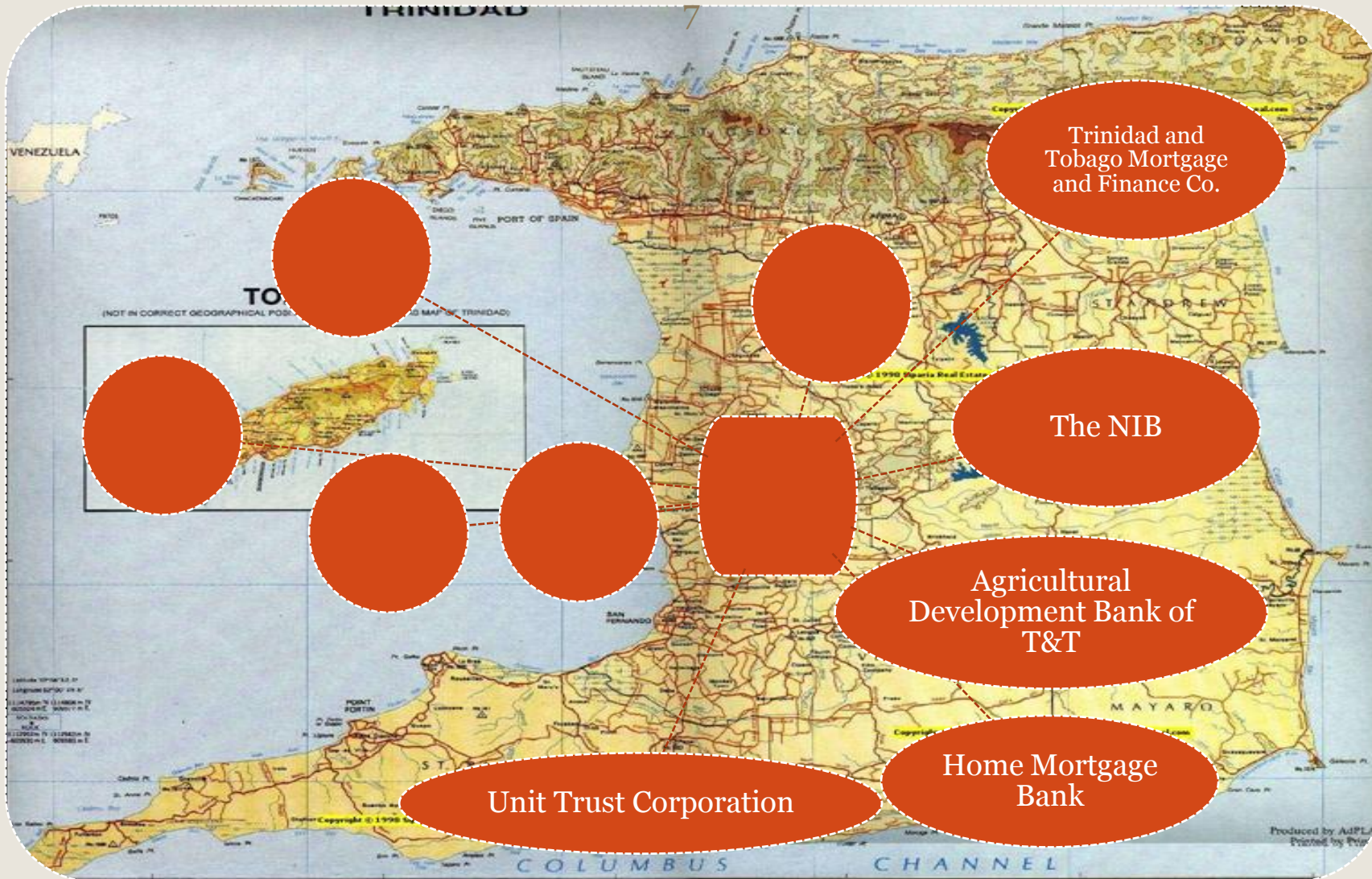
G-SIIs – Insurance Companies

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Institutions Designated SIFIs in TnT

Source: CB Governor, 2013, Press Release



Supervisory Approach Regional SIFI?

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- Aspects of the approach taken by the Central Bank of Trinidad and Tobago to deal with CLICO could be a good supervisory model to deal with regional SIFIs
- CLICO had the features of a SIFI, and therefore could be considered a regional SIFI based on its:
 - Size
 - Complexity
 - Interconnectedness

CLICO SIFI Profile

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- CL Financial reflected a highly complex and opaque business model.
- CLICO was the largest insurance company, and CLICO Investment Bank (CIB), was the largest investment bank in TnT.
- Both financial institutions were subsidiaries of the CL Financial Group, the largest conglomerate in the Caribbean.
- CL Financial encompassed over 65 companies in 32 countries with total assets exceeding US\$100 billion (CANA)
- Large scale public support would eventually be needed to prevent widespread disruption and loss of economic confidence

CLICO Profile of Weaknesses

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- Poor corporate governance and weak risk management practices made it difficult to assess the extent of exposures/potential spillovers.
- CL Financial Group became highly over leveraged and heavily interconnected.
- Both CLICO and CIB used aggressively high interest rates to finance equally high risk investments, much of which were in illiquid assets including real estate;
- Distorted incentive structures

CLICO Profile of Weaknesses

- Liquidity risk was higher than recognized. CLICO and CIB took on excessive maturity mismatches while failing to build adequate liquidity asset buffers;
- Capital was inadequate as a buffer against the sharp drop in asset prices, especially a rapid fall in methanol prices (a major source of dividends for the Group) and real estate values;
- The inter-connectedness of institutions meant that these shocks were propagated across the Group, both in Trinidad & Tobago and the Caribbean; and
- CL Financial was deemed ‘too-big-to-fail.’

CLICO Lessons Learnt

Source: TnT CB Governor, 2013, Press Release

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- We learnt the hard way about distorted incentives,
- We learnt about a severe lack of transparency,
- We learnt about inadequate capital and
- We learnt about inadequate liquidity buffers and, most importantly,
- We learnt about the problem of “too-big-to-fail”.
- We must also learn that this failure partly resulted from systemic weakness in the regulatory architecture and partly from excessive risk taking, both in regulated institutions and those outside the perimeter.

CLICO Estimated Cost?

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- The CL Financial crisis has cost TnT over \$20 billion dollars

A Regional Approach to SIFI Supervision: The TnT Proposal?

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- Building capacity through new talent acquisition / Hiring new specialized supervisory staff;
- Seeking passage of stronger legislation such as the Insurance Bill;
- Seeking control over systemically important financial institutions such as the Unit Trust Corporation;
- Examining the feasibility of a Single Financial Regulator; and
- Deepening the approach to supervision;
 - Intrusive
 - Proactive
 - Comprehensive

FSB Policy Measures to address SIFIs

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“A sound capital and supervisory framework for the insurance sector is essential for supporting financial stability”... Mark Carney (Governor Bank of England/Chairman FSB)



FSB Policy Measures to address SIFIs

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- More intensive and effective supervision of all SIFIs/stronger mandates, resources and powers
- Loss absorption capacity based on impact of default (1 – 2.5% of RWA to be met with common equity)
- Effective Resolution Regimes
 - Powers to resolve failing financial firms
 - Responsibilities
 - Instruments – purchase and assumption/good bank bad bank split
- Resolvability Assessment and Recovery and Resolution planning / Cross border cooperation agreements for home/host jurisdictions

Regional Interconnectedness



Financial Sector highly Concentrated and Connected in the Region

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	<u>Assets (US\$ mil.)</u>	<u>No. of Caribbean Countries</u>	<u>Percent of Total Caribbean Banking Sector Assets</u>
RBC Financial	11,686	20	22
Scotia Bank	10,145	21	20
First Caribbean International Bank	9,766	18	19
Republic Bank	9,315	6	14
SAGICOR Financial Group	4,867	22	NA
First Citizens Bank	4,015	4	8
Guardian Holdings	3,281	4	NA
JMMB	1,318	3	NA

Source: Caribbean Center for Money and Finance Newsletter, March 2012/Nita Thacker, IMF

The Case for a Regional Supervisory System

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Central Bank of TnT Governor:

“No one really knew what exactly needed to happen if a large systemically important institution became insolvent. At the end of the day, the decision to either bailout an institution or let it go bankrupt became a political not economic one”

Central Bank of TnT Governor:

“CL Financial enjoyed the benefits of being ‘too-big-to-fail.’ The implicit understanding was that if the Group ran into difficulties, the government would step in to prevent a systemic crisis”.

Framework for Comprehensive Supervisory Systems

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Crisis Management
Resolution and Safety
Nets

Supervision and
regulation

Legislation and
Institutional
Arrangements

Institutional Arrangement: Regulatory Structure across Financial Sector

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	Banks	Bank Licensing	Credit Unions	Insurance	Offshores
ECCU	ECCB	Ministries of Finance (MoFs)	National Supervisory Agencies (MoFs)	National Supervisory Agencies (MoFs)	National Supervisory Agencies (MoFs)
Jamaica	BOJ	Ministry of Finance (MoF)	Jamaica Cooperative Credit Union League	Financial Services Commission (FSC)	N.A.
Barbados	CBB	Ministry of Finance	Financial Service Commission (FSC)	Financial Service Commission (FSC)	CBB
Trinidad and Tobago	CBTT	CBTT	Commission of Cooperative Development (CCD), but plan to place the supervision of them in the CBTT	CBTT	N.A.
Bahamas	CBoB	CBoB	CBoB (ongoing)	Insurance Commission of the Bahamas (ICoB)	CBoB
Belize	CBB	CBB upon approval by MOF	CBB	Supervisor of Insurance (SOIP)	International Financial Services Commission (IFSC)
Guyana	BOG	BOG	not under the supervision of the BoG, but plans to do that sometime in the future	BOG	N.A.

Source: IMF Presentation, T&T Conference (Sept. 2012)

Institutional Arrangement: Regulatory Structure across Financial Sector

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	Banks	Bank Licensing	Credit Unions	Insurance	Offshores
Suriname	CBvS	CBvS	CBvS	CBvS	N.A
Haiti	CBH	CBH	CBH	Ministry of Finance	N.A.
Bermuda	BMA	BMA	BMA	BMA	BMA
British Virgin Islands	BVIFSC	BVIFSC	BVIFSC	BVIFSC	BVIFSC
Turks and Caicos Islands	TCFSC	TCFSC	TCFSC	TCFSC	TCFSC
Cayman Islands	CIMA	CIMA	CIMA	CIMA	CIMA

Source: Regulatory authorities

Framework for Comprehensive Supervisory Systems – Effective Legislation

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Ability to Set Minimum Capital Requirements and Issue New Regulations

- Institutions are different, posing different risks to financial stability therefore Supervisors should have power to set individual capital requirement based on risk.
- Ability to issue new regulations quickly without having to change the laws
- Framework to enforce regulations (OEM)

Ability to assess administrative fines not just on summary convictions.

- Insolvency laws archaic in need of revision, special resolution regimes for the resolution of regional systemic Insurance companies and banks
- Some regulators are amending laws to provide for regulatory fines for breaches

Information sharing and cooperation

- Signing of MOUs
- Regional protocol for information sharing
- Information sharing with other independent regulators
- Most countries have signed TIEA to avoid being on the OECD black list

Framework for Comprehensive Supervisory Systems – Effective Supervision

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Capital Adequacy and liquidity Requirements

- Most Authorities still use the Basel I framework
- Importance of Risk adjusted capital adequacy requirements
- Capital and Liquidity contingency planning (Basel III)

Implement Consolidated /Group wide supervision

- Formalize consolidated supervision framework
- Ability to set capital at parent and subsidiary levels
- Powers to request information from parent / holding companies and non-financial subsidiaries , branches of foreign firms

Implement Risk-based Supervision

- Formal Risk-based supervision framework in place
- Identify significant activities
- Macro Prudential monitoring
- Effective programme of on-site reviews and off-site monitoring

Framework for Comprehensive Supervisory Systems – Effective Supervision

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Enable Licensee Self Assessment

- Regulators are not the managers of firms
- Firms should set risk appetite, appropriate governance, appropriate policies, IA Capital risk mgn

Strengthen Supervisory Review Process

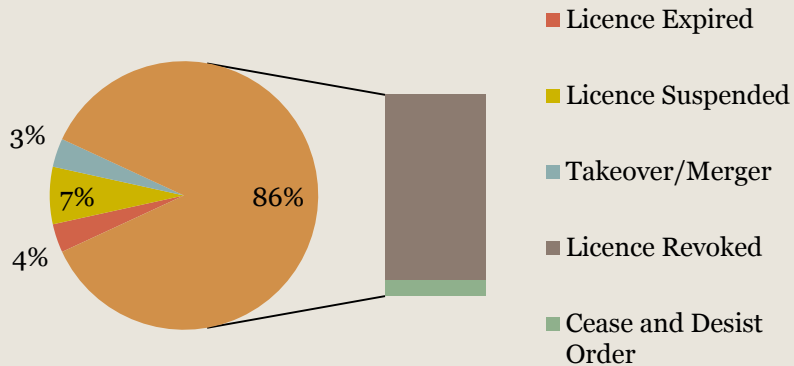
- Best Practice Standards – Bermuda, Cayman and Barbados
- Move beyond CAMELS and PEARLS; Comprehensive assessment of risk appetite, risk profile, risk management, governance, internal controls, pillar II risks
- Macro prudential Surveillance and Stress Testing

Encourage and Promote Market Discipline

- Best Practice standards – British Virgin Islands and Bermuda;
- Semi Annual disclosures of institutions capital components, risk management practices and governance structure
- BVI prolific in disclosure of fines and breaches

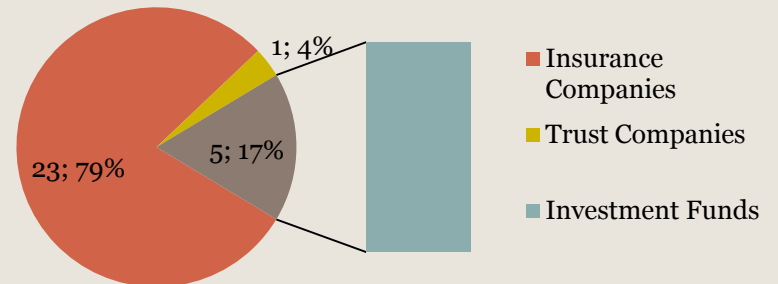
Market Discipline: Disclosure and Transparency

Outcome of Regulatory Breaches in BVI 2008 - 2013



Source: BVIFSC

Subject of Regulatory Breaches in BVI 2008 - 2013



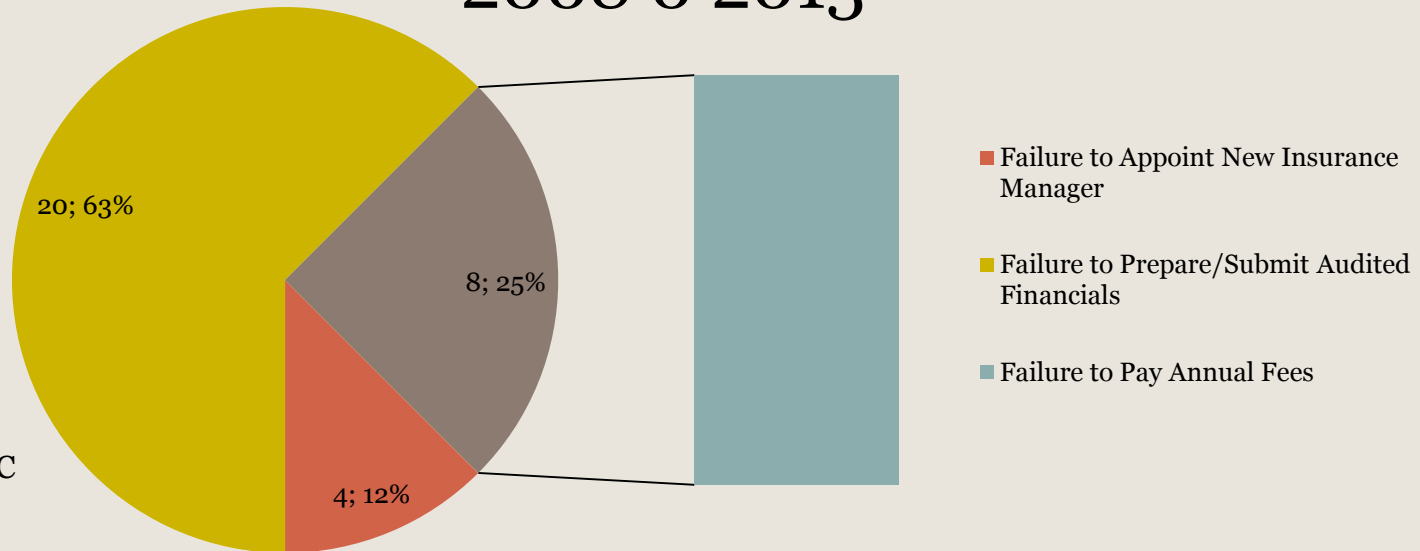
Source: BVIFSC

Market Discipline: Disclosure and Transparency

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Categories of Regulatory Breaches BVI

2008 to 2013



Source: BVIFSC

Other Violations include: (i) failure to implement remedial actions (ii) directors not fit and proper (iii) violation of anti-fraud provisions (iv) failure to notify of resigning director (v) failure to notify of new appointment of director.

Framework for Comprehensive Supervisory Systems – Effective Resolution Regime

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Plug Gaps in Financial Safety Nets for Depositors/Investors/Policy Holders

- Jurisdictions should have systems in place for:
 - Depositor Protection (DIS)
 - Investor Protection
 - Policy Holder Protection

Finalize and Implement Crisis Preparedness and Management/Cross Border Cooperation

- Triggers for financial crisis
- Communication protocols, information sharing
- EWS / monitoring / benchmarks
- Government stop gap– last resort
- CGBS Working Group

Conduct Resolvability Assessment Develop and test Recovery and Resolution Planning

- Regular evaluation/assessment
- Extent to which critical services and payment and settlement functions can continue
- Nature/extent of intra group exposures
- Capacity of firms to deliver timely and accurate information to support resolution
- Robustness of cross border sharing and cooperation arrangements

CARTAC Assistance on Capital Standards and Prudential Regulation

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- Basel II implementation in Barbados, ECCB/ECCU, the Bahamas, Jamaica, Trinidad and Tobago, Turks and Caicos, British Virgin Islands, Cayman Islands
- Developed and harmonized regulatory reporting standards ECCU
- Harmonize capital and actuarial standards / Jamaica; Regional
- Onsite and Offsite insurance supervision training
- Train-the-Trainer Workshop held on Credit Risk Assessment

CARTAC: Enhancing Financial Stability in the Region

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- Crisis Preparedness training via TA provided to Bahamas and Belize (simulating a banking crisis)
- TA provided to Central Bank of Trinidad and Tobago in developing stress testing methodologies and publishing stress testing results;
- Stress Testing TA to Belize to simulate impact on banking systems on stricter loan provisioning rules;
- TA to develop consolidated supervision and risk based supervision frameworks for the region / coverage of both banking and insurance supervision
- TA to develop and publish Financial Stability Reports in the Bahamas in progress.

CARTAC: Enhancing Financial Stability in the Region

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- Resuscitation of CAIR (Caribbean Association of Insurance Regulators)
- Convene the first College of Insurance Regulators
- Establishment of Single Regulatory Units in ECCU for non-banks and off-shore sector
- Diagnostic assessment completed for Credit Unions in the 8 ECCU countries
- New Credit Union laws passed in ECCU countries
- Offsite and Onsite supervisory framework completed for credit unions in Belize
- Deposit Insurance proposals for Suriname

Thank you