FOR INFORMATION

FO/DIS/20/177

August 25, 2020

To: Members of the Executive Board

From: The Secretary

Subject: **Trinidad and Tobago—Financial System Stability Assessment—Statement by the Executive Director**

Board Action:	Executive Directors' **information**
Additional Information:	The attached statement from the Executive Director for Trinidad and Tobago, is being issued on Trinidad and Tobago—Financial System Stability Assessment (SM/20/136, 7/31/20), which is being considered on a lapse of time basis.

Statement by Mr. Bevilaqua and Ms. Mohammed on Trinidad and Tobago—Financial System Stability Assessment

The Trinidad and Tobago authorities would like to thank staff for the comprehensive and fruitful discussions during the course of the FSAP engagement. Although the missions occurred prior to the onset of the COVID-19 outbreak, the authorities commend the team for the brilliant display of flexibility as COVID-19 scenarios were incorporated into the risk analyses, which have greatly complemented the report and enhanced its relevance during this period where financial stability risks have increased.

Since the last FSAP in 2010, financial soundness indicators (FSI) for both the banking sector and insurance companies in Trinidad and Tobago have generally been robust. Capital adequacy ratios have remained much higher than the regulatory minimum requirement, profitability has improved while asset quality and liquidity measures have been maintained at relatively high and stable levels. In July 2020, the Central Bank of Trinidad and Tobago (CBTT) released its 2019 Financial Stability Report (FSR) which highlighted the resilience of the domestic financial system. However, the FSR also noted that the institutions' strong capital positions could be eroded if potential vulnerabilities are exposed and key risks materialize.

Against this backdrop, the authorities concur with staff's assessment that the banking system is well-capitalized and liquid. They note the findings on financial vulnerabilities including energy dependence, rising household debt, increasing sovereign exposure and spillovers from natural disasters in the region, which are in alignment with their own assessment of financial stability concerns. The authorities appreciate the objective analysis and candid recommendations which provide further impetus to strengthen on-going efforts to address issues that affect financial system stability.

The timing of this FSSA is extremely crucial for Trinidad and Tobago, particularly as COVID-19 occurred while the economy was making positive strides to return to growth following three years of contraction over the period 2016 to 2018. This pandemic has stifled domestic activity in 2020 as restrictions to stem the outbreak were in effect. Over the past few weeks, a second wave of confirmed cases emerged, resulting in another bout of restrictions and heightened economic uncertainty. Although the financial institutions continue to be resilient and should be able to withstand any shock, prolonged effects from COVID-19 can threaten the stability of the financial system. Hence, the authorities continue to be vigilant and proactive as they monitor developments and coordinate actions to respond to emerging threats.

The report highlights the progress made by the authorities since the last FSAP—around the time when a systemically important financial institution (SIFI) failed—and mentions that further reforms are required to consolidate and leverage recent gains. As the authorities have been placing tremendous efforts on improving its regulatory and supervisory framework such as bridging legislative gaps, strengthening national and regional supervisory coordination, and refining its risk analytics for banks and insurance companies, our comments will focus on some of the findings and recommendations.

A. Legislative Issues

Regulation of the banking sector was strengthened by the recent promulgation of Basel II/III capital requirements. The authorities acknowledge that over the past decade financial sector legislation and regulations have not kept pace with international best practice. Despite this deficiency, the CBTT has been quite efficient with respect to overseeing and monitoring the financial institutions under its purview. However, the modernizing of legislation will greatly enhance the effectiveness of its supervisory oversight. To this end, some progress towards improving risk-based supervision and governance have been made. Since 2014, the CBTT commenced a consultative process with the banking sector on how to effectively implement Basel II/III. This was followed by quantitative impact studies to evaluate the implications of this policy change. In May, the Financial Institutions (Capital Adequacy) Regulations 2020 were given legal effect, allowing the CBTT to implement the new Basel II and Basel III capital requirements.

CBTT's supervisory effectiveness can also be impacted by the modernization of the Central Bank Act. In this regard**,** enhanced autonomy over its governance, decision making, and internal organization is necessary for the CBTT to align its operations with international best practice.

Meanwhile, legislative developments for the insurance sector are progressing somewhat slower than anticipated but the authorities remain confident that the new Insurance Act will be proclaimed later this year. The collapse of CL Financial in 2009 highlighted several shortcomings in the outdated Insurance Act. That legislation has since been comprehensively reviewed and the new Insurance Act, which was passed by parliament, is currently awaiting proclamation. When proclaimed, the new Act will significantly strengthen measures to boost corporate governance in the sector, increase the minimum capital requirement, support risk-based supervision and fortify the CBTT's regulatory powers.

B. Stress Testing of Banks and Insurance Companies

The results of the stress tests revealed that the domestic banking system should be able to withstand extreme but plausible shocks. The stress tests for banks were conducted under high levels of uncertainty due to the COVID-19 pandemic. Under the pre-COVID-19 adverse scenario and the COVID-19 central scenario, none of the banking institutions is expected to breach the minimum capital requirement over the three years to 2022. While the former scenario can be a useful reference point, it is now deemed to be unrealistic as the economic recovery in not likely to be "V" shaped. The COVID-19 central scenario, which is relatively more relevant, showed that the strong capital buffers in the banking system can absorb the negative fallout from a prolonged recession. In light of the recent increase in domestic COVID-19 cases, the authorities are paying special attention to staff's COVID-19 downside scenario stress test which showed that some banks could need additional capital in 2022. Given that there is some likelihood that this adverse scenario can occur, the high level of cross border activities and interconnectedness within the financial system suggest that the authorities must remain alert and continually exercise prescience during this global economic and health crisis.

The CBTT has been refining its stress testing methodology to capture the effects of multiple adverse factors occurring simultaneously and over a defined period of time. In that regard, the CBTT welcomes the recommendations to introduce scenario-based solvency stress tests and cash-flow based liquidity stress tests and will appreciate any technical assistance the Fund can provide.

The recommendations regarding data issues are also being actively discussed. While the CBTT recognizes the benefits of collecting data from licensed financial institutions in a flat-file format, it is unlikely to be implemented in the very short term as the institutions have indicated their need to invest in technology, improve data capture and employ additional resources. The CBTT will continue to explore ways to ease the transition burden on financial institutions and ensure that the flat-file format is progressively implemented.

The stress tests of insurance companies covered a large segment of the industry based on market size and the findings revealed that the sector is quite robust and can withstand shocks. However, staff noted that vulnerabilities to a series of severe natural disasters exist. The unpredictable nature and the increasing frequency of natural disasters (including climate-related) present a constant threat to the stability of insurance companies. The legislative improvements mentioned above will result in insurers having stronger capital positions while an expansion in surveillance tools will boost the monitoring of the sector. Over the next twelve months, the CBTT plans to introduce top-down stress testing of insurance companies to complement other surveillance efforts.

C. Systemically Important Financial Institutions (SIFIs)

In recent years, the authorities have made strides in designating and monitoring SIFIs. The supervision of SIFIs is shared among several regulatory agencies and the range of activities conducted by these SIFIs is diverse. The authorities agree that the powers and resources to supervise these institutions need to be strengthened but careful consideration must be given to understanding the uniqueness of some of the SIFIs. The CBTT has outlined in its five-year strategic plan the need to develop a strategy to monitor designated SIFIs and other large financial institutions that fall outside its perimeter. The CBTT has also been conducting regular on-site and off-site visits of SIFIs and recently engaged the IMF Caribbean Regional Technical Assistance Centre (CARTAC) for technical assistance to utilize network analysis tools to strengthen their surveillance.

D. Investment Funds

The mutual fund industry has continued to experience stable growth in assets under management. Some of the investment funds are deemed to have systemic impact based on their size and interconnectedness within their conglomerate structure. As such, the authorities acknowledge the contagion risk between investment funds and banks and have been cautiously monitoring developments within the industry. They are aware of the risks posed by investment funds under management carrying fixed net asset values (NAVs) while the funds are easily withdrawn. They concur with staff's recommendation to carefully sequence an industry-wide transition of investment funds to floating NAVs.

E. Other Issues

The authorities have been working arduously to improve the integrity of the financial system, strengthen the supervision of credit unions and finalize the national crisis management plan. The recent removal of Trinidad and Tobago from the Financial Action Task Force's (FATF) "grey" list in February 2020 was a major achievement for the authorities, and this is likely to ease some of the challenges faced by financial institutions to maintain correspondent banking relationships. On the credit union front, the issue of supervision is currently being discussed by the authorities who are carefully examining the structure of the industry, the safeguards and the most effective way to regulate the diverse set of co-operative societies. Meanwhile, the assessment of the banking sector against Basel Core Principles was welcomed by the authorities. The deficiencies identified will be actioned over time as legislative shortcomings are resolved and banking regulations and policy guidelines are updated. For the remaining duration of the CBTT's strategic plan FY2017-FY2021, several of the issues raised are expected to be addressed, including the operationalizing of a national crisis management/resolution plan.

Conclusion

The authorities thoroughly appreciate its engagements with the Fund and World Bank in this exercise and respect the high-quality assessments, candid views and recommendations. The FSSA supports some of the authorities' own assessment of the domestic financial system, while it accentuates important systemic issues that require greater priority. Over the past six months, the need to be agile has been crucial for the regulators as economic and financial conditions have been dynamic. The FSSA report will provide an important contribution to the authorities' blueprint involving concrete actions to maintain financial stability in Trinidad and Tobago.