FINANCIAL SERVICES COMMISSION (BARBADOS)

Anniversary Lecture

April 14, 2015

"Financial Innovation: Key Challenges that Regulators Face"

{COURTESIES}

Good Evening, Ladies and Gentlemen.

It is indeed an honour to have been asked by the Chairman of the FSC, Sir Frank Alleyne, to present this second lecture in your Anniversary Series, the first having been delivered a year ago, by Sir Trevor Carmichael on the topic ***"Regulation Today: Protector or Stimulus"***.

I had no hesitation in accepting this invitation as I have known Chairman Sir Frank since at least 1966/67. At that time, I was a young Lecturer at the UWI St. Augustine engaged in providing support to the Cave Hill Campus by working weekends lecturing in economics. Moreover, Sir Frank explained that I was being asked to follow no less a person than Sir Trevor Carmichael whom I had also met during my term as Chairman of the Trinidad and Tobago Securities and Exchange Commission. Trinidad and Tobago Citizens, like myself, do not often have the opportunity to interact with Knights of the Realm, and it was therefore impossible to refuse or decline the invitation of one "Sir" to follow in the footsteps of another.

During the course of my term as Chairman of the TTSEC, I had many interactions with the former Barbados Securities Commission – and I believe that Sir Frank may have succeeded Sir Neville Nicholls as Chairman of that institution. In that regard, I have experienced significant, but enjoyable, interactions with financial regulation in Barbados, including the oversight of the Neal and Massy (now Massy Group) acquisition of BS&T, and becoming involved in another set of weekend engagements discussing proposed changes to the Securities Act. I have also been involved, as a Consultant, in the development of the Barbados Deposit Insurance System.

Therefore, despite my unfamiliarity with all the current details regarding financial sector regulation in Barbados, I have had a sufficient engagement with the subject to feel comfortable about accepting Sir Frank's kind invitation.

This evening, I will discuss some of the challenges that are being faced by regulators, not only in Barbados, but around the Region and the world, in the post-Financial Crisis period. I have given my address the title ***"Financial Innovation: Key Challenges that Regulators Face"***, and I propose to explore five areas that combine issues of relevance worldwide, with issues that may be of more relevance in Barbados. In each of these areas, I venture to suggest approaches that the FSC might usefully wish to consider as it seeks to deal with the challenges that it faces. The five areas that I will explore are:

1. Establishing an appropriate balance between regulation and the freedom of the industry, particularly the securities industry, to innovate

2. The ability of the Regulator to keep pace with rapid changes in regulatory policies recommended by the several international regulatory standards bodies

3. Building and maintaining confidence in the domestic insurance industry following what we euphemistically refer to as the "CLICO Fiasco"

4. Maintaining the financial independence of the Regulator

5. Finding an appropriate framework for the regulation of the credit union sector of Barbados

In treating with these issues I will attempt, within the constraint of my limited familiarity with specific regulatory issues in Barbados, to make relevant references to the local situation.

Background – the Context

It may be useful to set a bit of a context for my discussion tonight. During the global financial crises in 2007-2009 and the Regional crisis brought about by the failure of CLICO in 2009, regulators often had to shoulder the blame for failing to properly regulate the entities under their purview. All over the world, therefore, there were concerted efforts to identify the causes of and the appropriate responses to the situation, as well as to examine the roles of the regulators and the expectations of the public in relation to financial sector regulation and to the regulators.

Among the responses, there have been proposals for the restructuring of the regulatory regime – as in the UK for example, and as in Barbados. Trinidad and Tobago is still debating the best way to undertake structural regulatory changes, with an apparent tendency to prefer centralising the regulation of all financial sectors – banking, insurance, pensions, securities, and credit unions, in a single regulatory authority – the Central Bank.

The question of regulatory structure is quite a huge one and there is, as yet, no universally acceptable, single and right model for its structure.

A second arm of the response has been to try to tighten the legal bases for regulatory regimes in an attempt to close gaps or limit opportunities for arbitrage among different regulators, rules and regulatory styles. We might include, as part of this response, the efforts of a number of international bodies to establish universal rules with world-wide applicability.

A third response was to adopt a change in regulatory approach, moving from a rules-based compliance approach to a risk-based approach, in which the regulator would now seek to ensure that each entity allocated adequate capital for its risk profile.

The FSC was born, in 2011, into this local, regional and global context.

Established as a single regulatory authority for all the financial sectors in Barbados excluding the domestic and offshore banking sectors (which remain under the purview of the Central Bank of Barbados) the Commission replaces a number of regulatory bodies, including the Barbados Securities Commission, the Commissioner for Cooperatives which was responsible for the licensing and supervision of the credit unions, and the agencies responsible for the supervision of the domestic and offshore insurance sector and for occupational pensions.

Consequently, the Commission supervises over 700 entities with assets in the order of $150 billion (almost 4 times the value of GDP). These include 35 credit unions; 26 domestic insurance companies; two hundred or more agents and brokers in the insurance sector; 23 listed companies; 26 mutual funds; 274 international insurance companies; 305 pension plans; the Stock Exchange and the Securities Depositary. This makes the Commission quite a unique institution.

Notwithstanding the diversity of its purview, however, this institution is, ultimately, intended to achieve the same purpose in respect of each of the sectors for which it is responsible. As set out in the statement of Objectives and Purposes of securities regulation established by the International Organisation of Securities Commissions (IOSCO), the objectives of the FSC may be stated as follows:

- Ensuring the protection of investors and participants in the financial sector
- Ensuring that markets are fair, efficient and transparent
- Reducing systemic risk, that is, potential damage to the entire financial sector

While IOSCO has set out some 38 Principles of Regulation through which these objectives are expected to be achieved for the securities sector, the International Association of Insurance Supervisors (IAIS) has similarly set out some 21 Insurance Core Principles (ICPs) for achieving similar objectives and purposes for insurance regulation.

This means that for perhaps the two largest sectors to be regulated by the FSC there are some 59 international standards – each of which may also carry multiple guidelines or procedures – to which the Commission is required to adhere. I trust that this gives you a good sense of the complexity that the Commission faces and is required to manage.

For each particular sector, however, achieving these three common objectives presents different challenges; for example, it is clear that the risks from which credit union members may require the protection of the regulator differ significantly from those faced by investors in securities, and those faced by participants in the domestic and offshore insurance sectors. Consequently, the requirements for ensuring such protection as may be appropriate to members of credit unions will differ significantly from those that are likely to be appropriate for each of the other groups of consumers or investors.

Similarly, the operations of the markets and the requirements for fairness, market efficiency and transparency differ significantly in each of the sectors. There is, for example, a defined market for the creation and trading of securities, usually through the Stock Exchange. Transactions for customers/investors are undertaken on their behalf by brokers and not by the investors themselves, and this provides opportunities for manipulation and other conduct that may be of disadvantage to investors. However, credit unions and insurance companies usually deal directly with customers and thus present different issues of fairness, efficiency and transparency.

On the other hand, not all of the sectors – the offshore industries, for example – pose a direct threat to the integrity of the Barbados financial system. To be sure, the offshore insurance and mutual fund industries are important parts of the Barbados economy and their performance and the maintenance of confidence in them are very important, perhaps even critical, to the overall strength of the economy. Therefore it is clear that the FSC's responsibility for regulating these offshore businesses, while not impacting directly on system stability and systemic risk, certainly does potentially have implications for the stability of the economy and through that instrumentality, for the potential stability of the financial system.

In sum, what needs to be done in respect of the regulation of each sector is likely to differ materially from sector to sector.

Against this background, I will seek to address the five issues that I set out at the beginning of this presentation.

- ***Regulation and Innovation***

The first issue is that of the alleged conflict between the increasingly demanding requirements of the regulation of financial entities and their ability to continue to widen and deepen financial markets by developing new and innovative products and services. Particularly in the securities sector these are often posed as completely incompatible polar opposites. I beg, however, to disagree.

In the past, regulation, in practice, has tended to be very much an ***ex-post facto*** event. The market does, and the regulators later try to check and keep pace, in order to achieve the overarching objectives of regulation. I sometimes describe much of the pre-2009 approach to regulation as an "audit" approach. That is, regulators tended to focus on what had taken place in a prior period, rather than on seeking to forestall a future occurrence of entity or system failure and loss to investors. In such a framework, there was considerably less emphasis on capital and risk profiles, once certain disclosure standards had been satisfied.

Since the onset of the global financial crisis in 2007 – 2009 however, regulators have been reviewing the effectiveness of their traditional regulatory tools, such as establishing processes and procedures for the registration of participants and products and for disclosure; the conduct of on-site examinations, particularly of commercial banks; and the use of enforcement actions, defined and driven by legal requirements, to assure compliance.

The financial crisis demonstrated clearly that even in the most proficient of regulatory environments this ex-post facto approach was quite inadequate to protect the major financial systems of the world, and indeed the whole world from an ultimately devastating systemic failure.

Consequently, regulators have, over the past 5 years or so, increasingly adopted a risk-based approach to regulation. This is accomplished by examining the risk profiles and size of individual entities to try to ensure that excessive risk is not undertaken and that capital, adequate to that risk profile is allocated. If these conditions are satisfied, the institution should have adequate capacity to ride out a crisis without collapsing into absolute failure and exposing the entire system to the risk of collapse.

As a result, what has recently been happening as part of a growing international trend of risk-based regulation, is that more emphasis is being placed on ensuring that firms allocate adequate capital for their products and operations. All business activity is subject to risk, and it is the capital that has been allocated in the business that protects the entity, and its customers, from failure.

I think that you may rely on my assurance that the objective of the regulators is not to limit the innovative juices of the market place, but to ensure that the products that are developed are transparent enough to be understood by potential investors and pose no undue risk to customers, the institution and the financial system. The risk-based approach being adopted by regulators is intended to permit them to satisfy themselves that at all times, all financial entities have sufficient capital to ensure that their inherent risks can be absorbed and distributed internally without the likelihood of a catastrophic failure of the entity.

This is the interface at which the perceived conflict between regulation and innovation in the financial sector arises.

It might be useful to recall that much of the source of the financial crisis of 2007 – 2009 derived from the absence of capital in respect of products that were "highly innovative" and, as it turned out, improperly understood even by the CEOs of the responsible institutions who lined up, one by one, to admit to the US Congress that they had no idea of what they were selling, although these products made them and their companies so much money.

In the end, when the absence of capital in specific entities begins to threaten the stability of the system as it did globally in 2007/2009 and in the Caribbean in 2009, it is the general public, as taxpayers, who end up paying the bill.

Beyond the protection of consumers in the individual enterprises, the major concern of regulators is the threat that the potential failure or collapse of a specific entity may lead to a collapse of the entire system. This may occur through a crisis of confidence, or through the inter-connectedness of businesses.

The 2007/2009 global financial crisis started with difficulties among investment banks which were, generally, very lightly regulated unlike commercial banks. When the authorities decided that Lehman Brothers was not significant enough to require a bail out by the Federal Government, they were surprised by the impact that that decision had on market confidence and on the other investment banks. The threat posed by the potential loss of confidence – and we must always remember that confidence is the bedrock of the financial markets, ultimately led to the concept of a full bailout of the investment banking sector.

As for the issue of inter-connectedness, the threat emerged for the entire housing market in respect of which more and more sophisticated financial products, with less and less connection to real values in the housing market, were created and sold worldwide. These products and their derivatives had become significant in the balance sheets of many banks, as well as the Federal Home Loan Mortgage Corporation, the insurance industry and non-financial businesses all over the world.

Here was a real threat to the operations not only of the financial market place but also to businesses in the real sector, particularly the housing market.

In the case of the regional CLICO crisis, the CL Financial Group appears to have exhibited many of the characteristics of inadequate capital, high debt and significant interconnectedness that were features, for example, of the crisis in the US. The Group had built up an empire of more than a hundred unregulated companies on the basis of a dozen or so regulated insurance companies, financial institutions and securities companies throughout the Region. By the end of 2008, the CL Financial/CLICO empire had grown to some TT$100 billion and rested on equity capital that was no more than TT$15 million and huge leverage, in excess of 90%, in the form of debt. The combination of inadequate capital, high leverage and wide-spread inter-company transactions with non-regulated companies ultimately contributed to the onset and severity of the crisis.

The repeat of such threats is the eternal nightmare of financial sector regulators. In order to minimise such threats, regulators have developed a variety of standards to address some of the things that they learnt about so painfully, including the fact that conglomeration, both within countries and cross border, does in fact constitute potentially huge risks and should be regulated in some manner.

This has led to consideration of a new approach to regulation to which the Governor of the Central Bank of Trinidad and Tobago adverted in an address to a Conference of the Caribbean Group of Banking Supervisors in June 2014. Here is what Governor Jwala Rambarran said to the Banking Supervisors:

> *"The CLICO crisis taught us that it's even more important for supervisors at all levels to keep their eyes on the ball, at all times. Here at the Central Bank of Trinidad and Tobago, we are instilling in our supervisors the need to be more intrusive. Our supervisors must no longer stay on the sidelines of regulated financial institutions, relying solely on the results of institutions' "internal controls and risk management systems". Over the past five years, supervisory priorities at the Central Bank of Trinidad and Tobago seem to have been seriously affected by the CLICO crisis, leading to a more legalistic approach to dealing with supervised institutions. I find supervisors are displaying an overemphasis on compliance and formal letters notifying institutions of sometimes minor breaches, which, in my respectful view, is diverting attention away from important issues of safety and soundness of institutions."*

Governor Rambarran uses the term “intrusive” to describe the proposed approach to regulation, and it is this intrusiveness that frightens industry participants and leads them to shout about regulation stifling innovation.

In my view, to the extent that the recommended intrusiveness focuses on risk assessment and risk management in accordance with well-accepted international standards, it is more than justified. In our democratic societies while we all have freedom, we do not have the freedom to burn down the town!

- ***<u>Keeping Pace with International Regulatory Developments</u>***

This brings us to the issue of trying to keep pace with all the new developments that are taking place across all the regulatory landscape, led of course by the major countries. I have had the personal good fortune to have been able to participate in some of that activity before retiring as a regulator – Chairman of the TTSEC – in 2009. What was interesting about that experience was that in 2007 – 2009 regulators all over the world were struggling to understand what had happened and why. However, the major countries, particularly the United States and the United Kingdom – the repositories of the world’s largest and most influential financial markets – had to proceed apace in order to protect their own financial sectors and economies, and much of this was done independently, characterised by the nature of the problem as each country saw it. Later, much of what was considered in that context came to form the basis of the new international standards.

The question we must ask ourselves, however, is “should we worry?” and should we break our necks to comply with these myriad standards that are emerging. I am not convinced that we should, at least not for every last one of them. In the first place, many of the issues being addressed by the new international standards are either not applicable to us or may represent relatively insignificant risks in our circumstances. I recall that at the onset of the global crisis both the Central Bank and the Securities Commission in Trinidad and Tobago polled their registrants to determine the potential direct impact of the emerging crisis at that time. We were very heartened to learn that there was likely to be insignificant impact on the market. Our crisis came from the conglomeration effect of the CL Financial Empire!

Secondly even among the major jurisdictions where some of these issues are of significant import, the results of monitoring exercises on the implementation of standards suggest that jurisdictions differ, sometimes significantly, on how and how completely some of these standards are adopted.

For example, in August 2013 the IOSCO and the (global) Committee on Payment Settlement Systems reported on the implementation of the 24 standards or principles that had been established in 2012 on Financial Market Intermediaries – referred to as the PFMIs. That report concluded that among 27 of the largest and most influential jurisdictions surveyed on a self-assessment basis, including the US, UK, European Union and Latin American giants such as Brazil, Argentina and Mexico, most jurisdictions were in the process of implementing the PFMIs … and that jurisdictions implement the PFMIs in very different ways.

While this is not finally conclusive it suggests that jurisdictions, taking their legislative and market conditions into account, may be judicious about the pace at which they seek to implement many of the standards that have been proposed and developed.

Given the relative youth and obvious resource limitations of the FSC and the relative thinness of Barbados financial markets, it would appear that the "judicious" route might be considered for this regulator in respect of the large number of standards and requirements that will come its way.

Having said that, there are some standards, such as those relating to Anti Money Laundering and Combating the Financing of Terrorism (AML/CFT), in respect of which there are serious financial and economic pressures that force early compliance and limit the possibilities for adoption of the judicious route. The overall economic development of the country's financial markets and the economy will, ultimately, dictate which standards are adopted, when and how completely. Hopefully, you will have easy access to the resources that would be required to fulfil your mandate.

- ***Confidence in the Insurance Sector***

In the post 2009 period the domestic insurance sector has undergone a marked change. A newly dominant entity has emerged and appears to have taken up a great deal of the slack created by the absence of a fully active CLICO International Insurance Company (CIL). The IMF Financial Sector Assessment Program (FSAP) reports the position of the sector as follows:

FSAP on Insurance Sector

> *"The insurance sector represents a considerable part of the financial system and is highly concentrated, especially life insurance. It consists of 23 active companies, six of which provide life and related health insurance policies, 16 offer general insurance focus (on property and commercial insurance contracts), and one company conducts both businesses. With the collapse of Colonial Life Insurance Company (CLICO) in 2009, a regional group based in Trinidad and Tobago, the life insurance sector became further dominated by the second largest insurer, which now accounts for 83 percent of the total assets of the life insurance industry.*
>
> *The insurance sector faces challenges. Premiums (net of reinsurance ceded) of life insurers have declined in recent years due to the weak regional economy and weakened public confidence. Although low and stable claims ratios have helped ensure profitability, assessing the soundness of general insurers is difficult owing to the absence of a robust liability valuation framework. An insurance-based group faces increased risk due to expansion in non-insurance businesses, reflected partly in a significant increase in holdings of Caribbean government debt securities".*

Indications are that this new giant may now account for 30% or more of the entire domestic industry, a size that has been achieved by significant conglomeration throughout the Region – Jamaica, Barbados, the Eastern Caribbean – and by its participation in the resolution efforts by the authorities in the Eastern Caribbean.

This forms the background for considering the questions of confidence in the sector and the challenge of regulating the sector, going forward.

With total assets of just under BDS $3 billion in 2013, the Barbados insurance sector represents approximately 37% of total financial sector assets and perhaps

7% of GDP – the financial sector accounting for approximately 20% of GDP. However, as indicated in several sources including the FSAP Report and the FSC's own Annual Report for 2014, the sector has still not recovered from some of the impact of the 2009 crisis and has, in the most recent reports, shown a decline in profitability. The FSC and Financial Stability Reports also show what appear to be significant changes in the structure of the sector.

Between 2012 and 2013, total industry premiums earned increased from $647 million to $655 million, an increase of approximately 1%. Despite the apparently sluggish performance, there was a change in the source of industry premiums which perhaps ought to be noted – and that is that over the period life insurance premiums increased by about $18 million or almost 12% (from $153 million to $171 million). On the other hand property insurance premiums fell by about $ 18 million from $211 million to $ 193 million. There was also a decline in motor insurance from $164 million to $162 million. Maintenance of this shifted pattern into the future might well indicate an important shift in consumer attitudes towards the industry, at a time when full confidence has not returned to the economy, although there are indications that the critical tourism sector may be on the brink of sustainable recovery.

On the other hand, indications of the recovery in industry profitability have not yet emerged. Industry profitability increased from $39 million in 2012 to $ 97 million in 2013, but that is still a significantly smaller value than the $246 million earned in 2011.

It is clear that confidence in the insurance sector will not likely reach pre-2009 levels in the context of the still sluggish growth of the economy and the as yet unresolved matters relating to the insurance portfolios of CIL. I would imagine therefore that in order for the required level of confidence to be restored, the first requirement would be for the overall economic outlook for Barbados to reflect sustained and sustainable growth in the near future.

A second element for the restoration of confidence in the insurance industry would be for a final resolution of the CIL portfolios to be determined and implemented. The uncertainty that currently surrounds this issue does not contribute to improving public confidence in the industry.

In this context of lowered confidence and performance levels for the industry, the challenge for the FSC as the regulator would be to try to facilitate the early resolution of the CIL matters – although in the current circumstances the FSC appears not to be the most central of the parties with the most direct roles in achieving such a resolution; those key parties appear to be the Judicial Manager, the Government and the Courts.

In the meantime, the regulator will need to focus on the growth of a potentially "too-big-to-fail" institution – one with many links around the Caribbean and elsewhere – to ensure that the catastrophe that appeared on our horizons in 2009, does not repeat itself. This will challenge the FSC's skills in risk-based regulation, in regulation of a large regional conglomerate and in developing the tools and technologies of regulation, including the management of its Colleges of Regional (and international) regulators, in order to achieve stability in the insurance sector, and I daresay in the entire Barbados financial sector and economy.

We may be reminded that the crisis of 2009, as it came to a head in Trinidad and Tobago, sharply affected the fortunes of all the insurance (and other) companies that operated as part of the CLICO/CL Financial Group in Barbados – as well as in the OECS, Guyana, Suriname and the Bahamas. In Barbados, the CLICO International Insurance Company (CIL) had by that time become one of the largest insurance companies in the country and conducted substantial insurance operations in the Eastern Caribbean as well. The Judicial Manager for CIL reports that at March 2012, the book value of the assets stood at $765 million of which $571 million were in Barbados with the remaining $194 million located in a number of OECS countries including $ 123 million in St. Lucia.

At that time, the insurance liabilities of the company were assessed at $837.4 of which insurance liabilities in Barbados were some $364 million – which means that insurance liabilities in the Eastern Caribbean were larger than those of Barbados even though the majority of the assets were in Barbados.

The Barbados insurance liabilities included $176 million of traditional insurance policies and $188 million of the various types of EFPA product which came to be called, in Trinidad, the STIPs – short term investment products.

As an indicator of the relative size of CIL in the Barbados insurance sector, the assets at book value, reported by the JM, represented just under 20% of the total assets of the sector in 2012.

Just about half of the business of this company was in the so-called STIPS and the crisis of 2009 effectively saw the disappearance of the STIPS as a line of business, while significant efforts continue to be made to maintain the traditional business since that time.

However, as recent news reports and commentary have shown, it appears that there is now likely to be an increasingly pressing need for new capital to be invested in order for the traditional portfolio to maintain its viability.

The challenge for the Commission in regulating the industry going forward will clearly be to ensure that the growing signs of concentration and conglomeration in the industry are effectively regulated. Much of the 2009 crisis was the result of the effects of these risks, we may remember. In these circumstances, I would anticipate that the intrusiveness of which Governor Rambarran speaks will become more evident in Barbados.

From where I stand, the Commission has taken all the right steps to achieve this huge responsibility. It has issued a number of guidelines for the regulation of the industry; it has strengthened its skills in risk based supervision, including its ability to conduct on-site supervision of the sector (and the other sectors under its purview); and it has made significant strides in building its relationships with local, regional and international regulators and regulatory bodies. These steps will help it to deal effectively with the specific risks that may be presented by specific entities, as well as ensure that is in the best position and equipped always with the right resources to regulate a financial sector with increasingly international connectivity.

- ***Financial Independence of the FSC***

Let me turn now to the issue of financial independence for the Commission.

The financial (and political) independence of the regulator is one of the important international standards which all regulators are required to observe. However, this requirement could be quite difficult to achieve particularly in smaller jurisdictions with relatively small financial markets. The FSC clearly faces a challenge of achieving full financial independence in a situation where in 2014 only 85% of its expenses were derived from the fees and other incomes it earned. This means that there existed in 2014 and may continue to exist in the future a reliance on subventions from the State.

Taken together with the extent of the authority of the Minister in respect of appointments and salaries etc, there is the risk that for some foreseeable future, the Commission may not be able to fully satisfy the international standards for independence. It is my understanding that those issues of independence that may be related to the role of the Minister are already being addressed and the Commission is in the process of making appropriate recommendations in that regard.

On the financial side, the creation, in the Act, of a Fund from which expenses of the Commission are to be met is an extremely valuable and important mechanism that would assist in the Commission in satisfying its goals of financial independence.

On the basis of the 2014 financial results, it appears that the Fund, which at that time stood at just about $800,000, should really be of the order of $25 million, from which earnings on investments would likely generate the shortfall in fee and other income without a reliance on operational subventions from the Government. Of course this target is based on current conditions and as the Commission gears up to discharge its mandate, it may find that its expenses continue to outstrip its ability to levy fees on the market and so the gap may become wider.

In those circumstances, if the capital of the fund could be rapidly increased over the next few years, then that would serve the objective of achieving financial independence.

Alternatively, if the current income for the Commission could be increased, that would also achieve the required conditions for financial independence. However, in as small a market as Barbados, that may be extremely difficult to achieve by way of an increase in fees.

On the other hand, there may be other mechanisms for increasing the income of the Commission. In Trinidad and Tobago the new Draft Insurance Bill provides for a number of contraventions to be addressed either by fines imposed by a Court, or by the application of Administrative penalties – usually of lower values than the Court may be able to apply. It is difficult to imagine, for example, that a contravention such as late filing of annual returns must be enforced by a Court rather than by an Administrative penalty. The appropriation of such Administrative penalties to the Fund may well be a mechanism for increasing the value of the Fund and for assuring the financial independence of the Commission.

The Sixth Schedule of the Trinidad and Tobago Draft Insurance Bill (2013) provides for some 78 potential contraventions applicable to insurers. The Court imposed fines, applicable on summary conviction, range from $300,000 to $600,000. Where the contravention is a continuing one, for late submission of a required report, for example, the Court may impose a further daily penalty, ranging from $30,000 to $50,000 for each day the breach continues. The regulator – the Central Bank in this case – may invoke the alternative of imposing an administrative penalty or fine for each of the same contraventions, ranging from $75000 to $125,000. Where the contravention is of a continuing nature, the administrative penalty may range from $5,000 - $10,000 per day for each day that it continues.

For the purpose of estimating the potential impact of these administrative penalties, I have crudely estimated that approximately $5 million would accrue to the regulator per year if there is one occurrence of each of the contraventions, and assuming the time based penalties are applied for one day each. In Barbados currency this would be equivalent to almost $1.5 million per year!

The introduction of such administrative penalties and the allocation of the proceeds to the Commission's Fund would of course require an appropriate amendment to the Act.

Since the achievement of financial independence is a function of the level of expenses of the Commission in relation to the capacity of the market to generate the fees that are its income, the Commission will need to be careful about how expenses grow as it ramps up the resources that it requires to properly regulate the market. In this regard, the Commission may wish to consider whether it might be useful to build up part of its capacity with a focus on market conduct issues that would cut across different financial sectors, while another part of its resources focuses on prudential issues, including risk management, which in any event seem to be converging across industries.

In a sense, as one considers such an approach, it brings into focus the issue of effectively regulating the credit unions sector.

- ***Regulating the Credit Union Sector***

The recent commentaries of the IMF FSAP Report of 2013 and of Sir Trevor Carmichael's address in last year's FSC Anniversary Lecture identify the need to recognise the disparities that exist within the Credit Union sector for regulatory purposes.

The sector comprises some 35 credit unions with total membership of over 150,000 – that is more than half the entire population of the country - and combined assets of some BDS $1.7 billion and ranging in size from $130,000 to $900,000. Of these, 23 credit unions or 66% of the total number have asset values of less than $10 million each, and control 3% or less of the total assets; 10 (29%) control some 24% of the assets ($405 million) and the remaining 2 (6%) control some $1.25 billion or 73% of the assets and are of a size that equates them with some of the non-bank financial institutions (Part III companies) regulated by the Central Bank.

The sector is mature and its importance to the Barbados economy is characterised by high levels of penetration reported at 72.6% of the economically active population. This represents the fourth highest penetration level in the world after St. Vincent and the Grenadines - 86.2%; St. Lucia - 75.2%; and Ireland - 73% according to the World Council of Credit Unions Report 2012.

Of the two largest credit unions, one is almost twice as large as the other, and, combined, assets under their control are valued at some 79% of the assets of the non-bank financial sector. Clearly the stability of these two institutions will form part of the concern for the overall stability of the financial system.

Sir Trevor expressed concern with the potential impact that the imposition of the proposed standards may have on the culture and operations of the credit unions given their history in the economic development of Barbados. The FSAP on the other hand expressed a view that a two-tier approach might be taken in regard to the regulation of the sector – presumably with the standards being more rigorously applied to the much larger credit unions, especially, I would assume, those that operate as fully open institutions with few or no requirements for special affinities. The second tier, with perhaps a much lighter touch, might then be applied to the smaller, affinity based credit unions which in any case represent little if any threat to the stability of the financial system.

Given that the Commission needs to pay attention to the need for financial independence, the adoption of such a two-tier approach might also permit it to better rationalise its resources and maintain the required level of cost efficiency.

Conclusion

In covering the issues that I identified at the start of this presentation, I believe that I have posed a number of challenges to the Commission on this its fourth anniversary. I have challenged it to be resolute in seeking to regulate all the sectors under its purview while maintaining an appropriately judicious relationship with the international standard setters; I have encouraged it to explore avenues for achieving financial independence and to make critical decisions about how to proceed with the regulation of credit unions.

I am confident, however, that these are challenges that the Commission is well placed to meet comfortably.

The performance of the Board and Management of the Commission over the four years of its existence is ample testament to both the success that it has had to date and to its capacity and ability to competently and effectively meet its future challenges.

I thank you.