Republic of Trinidad and Tobago

REFORM OF THE FINANCIAL SYSTEM

OF

TRINIDAD AND TOBAGO

A WHITE PAPER

MINISTRY OF FINANCE

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LIST OF ABBREVIATIONS

ACH	Automated Clearing House
ADR	Alternative Dispute Resolution
ATM	Automated Teller Machines
ATTIC	Association of Trinidad and Tobago Insurance Companies
BATT	Bankers Association of Trinidad and Tobago
BIR	Board of Inland Revenue
CARICOM	Caribbean Community
CARICRA	Caribbean Credit Rating Agency
CBTT	Central Bank of Trinidad and Tobago
CCULT	Co-operative Credit Union League of Trinidad and Tobago
CPC	Chief Parliamentary Council
CSME	CARICOM Single Market and Economy
CUs	Credit Unions
CUSU	Credit Union Supervisory Unit
DACs	Deposit Administration Contracts
DIC	Deposit Insurance Corporation
FIA	Financial Institutions Act of 1993
FTAA	Free Trade Area of the Americas
GATS	General Agreement on Trade in Services
GSD	Government Securities Depository
HMB	Home Mortgage Bank
IADB	Inter-American Development Bank
IAIS	International Association of Insurance Supervisors
ICATT	Institute of Chartered Accountants of Trinidad and Tobago
IFRS	International Financial Reporting Standards
IPO	Initial Public Offer
MTI	Ministry of Trade and Industry
MOF	Ministry of Finance
NIS	National Insurance System
OAP	Old Age Pension
OECD	Organization for Economic Co-operation and Development
OECS	Organization of Eastern Caribbean States

PEARLS	Protection; Earnings; Asset Quality; Rate of Return; Liquidity; Signs of Growth
QIC	Qualifying Investee Company
RTGS	Real-Time Gross Settlement System
SEC	Trinidad and Tobago Securities and Exchange Commission
SIA	Securities Industry Act of 1995
TIDCO	Tourism and Industrial Development Company
TTCD	Trinidad and Tobago Central Depository
TTSE	Trinidad and Tobago Stock Exchange
UTC	Unit Trust Corporation of Trinidad and Tobago
VCC	Venture Capital Company
VCIP	Venture Capital Incentive Program
WTO	World Trade Organization

WHITE PAPER ON THE REFORM OF THE FINANCIAL SYSTEM OF TRINIDAD AND TOBAGO

EXECUTIVE SUMMARY

(i) Introduction

The report is divided into five main sections. Section 1 explores the vision for the economy, noting the importance that government has placed on the attainment of the status of a developed country. Section 2 presents detailed analyses of the main sectors that make up the financial system, emphasising structure, performance, financial architecture, major weaknesses, and challenges and opportunities. Section 3 presents the vision for the development of the financial system in Trinidad and Tobago in the context of international developments, the emerging global financial environment and the role of government in achieving the vision for the economy. Section 4 develops a number of general and sector-specific recommendations to guide the future development of the financial sector, while Section 5 outlines the infrastructural developments, the legislative agenda and the implementation schedule for the financial system that are necessary to lay the foundation for the establishment of a Pan-Caribbean Financial Centre in Trinidad and Tobago.

(ii) Vision for the Economy of Trinidad and Tobago

As a middle-income developing country, Trinidad and Tobago has been enjoying an uninterrupted period of positive economic growth over the last decade. Much of this growth is a reflection of the increased activity in the energy sector - which provides the largest share of state revenue. This has led to a favourable macro-environment characterized by low inflation, a stable exchange rate, a healthy foreign reserves position and a declining rate of unemployment.

While the economy has weathered the recent global and regional slowdown relatively well, the dependence on the energy sector remains a challenge. Notwithstanding this, however, the medium-term prospects for the economy appear quite strong as real GDP is expected to grow on average between 4-6 percent per annum.

Against this backdrop, the Government of Trinidad and Tobago has identified the achievement of developed-country status by the year 2020 as the principal developmental goal of the country. This entails the development of a flexible, vibrant and diversified economy, supported by a stable and well-regulated financial services sector that can respond adequately to changes in the international environment. An educated and healthy human capital base will also be a critical requirement in achieving this goal.

(iii) The Existing Financial Landscape of Trinidad and Tobago

For the past forty years, the local financial system has been responding to a constantly changing macroeconomic environment and has made some significant strides. Beginning with an underdeveloped structure that consisted of a limited range of institutions and financial instruments in the 1960s, the system has emerged as a relatively sound and well-developed financial system when compared to most countries in Latin America and the Caribbean.

This evolution was facilitated by a number of factors including:

- The increase in oil prices in the 1970s that boosted economic growth and led to an increase in the number of financial service providers (banks and non-banks).

- The financial sector development plan implemented by government, beginning in the 1970s with the localization of the banking and insurance sectors and continuing into the 1980s with the formalization of the capital markets and the establishment of supporting institutions such as the Deposit Insurance Corporation (DIC), the Home Mortgage Bank (HMB), the Trinidad and Tobago Stock Exchange (TTSE) and the Trinidad and Tobago Unit Trust Corporation (UTC).

- The merger of three indigenous banks into one new bank with majority government ownership.

- The widening of capital market activity to include retirement plans denominated in US currency, individual deferred annuity plans, and mutual funds including offshore equity funds.

- The alliances between the insurance and banking sectors.

- The enhanced regulation and supervision of the financial system with the passage of the Financial Institutions Act, 1993, and the move to risk-based supervision by the Central Bank.

- The move towards a more open economic system and the concomitant dismantling of overt barriers to trade and financial flows, reflected in the liberalization of the foreign exchange market and cross-border capital flows.

- The globalisation and regionalisation of markets, including financial markets.

Since the onset of financial liberalization in the early 1990s, the complexity of the financial system has grown. A number of financial conglomerates have emerged and have been expanding their operations in both the domestic and regional markets. The existence of these complex institutions and the cross-country exposure that occurs raise issues of potential contagion and the management of systemic and liquidity risks.

Notwithstanding the significant strides that have been made in developing and strengthening the financial system, there still exist a number of weaknesses in the legislative, regulatory and supervisory frameworks and a need for the consistent application of financial standards. These weaknesses must be addressed if the goal of becoming a Pan-Caribbean Financial Centre is to be realized.

While institutional changes and legislative reforms have been implemented and updated for the banking sector, the legislative framework for the rest of the industry needs to be modernised. The existing legislation does not provide the regulatory authorities with adequate powers to regulate and supervise the financial sector in accordance with internationally accepted standards.

The existing regulatory and supervisory framework is fragmented and the system is now subjected to three different Regulatory Authorities - namely, the Financial Institutions Supervision Department, which falls under the umbrella of the Central Bank, the Commissioner of Co-operative Societies and the Securities and Exchange Commission - some more effective in their supervision than others. There is therefore a critical need to upgrade the regulatory framework to provide for a single Regulatory Authority.

Currently, not all institutions in the financial system are subjected to financial reporting standards that conform to the International Financial Reporting Standards (IFRS). The implementation of international standards for information disclosure and reporting must be undertaken so as to promote market transparency, improve the standards of corporate governance and allow for the effective sharing of information among local, regional and international regulatory authorities as well as provide information to consumers.

Other significant weaknesses impacting the system include an uncompetitive taxation regime, absence of a competition policy, a monopolistic telecommunications infrastructure and the lack of internationally recognised certification and accreditation requirements for persons providing financial services of an advisory, investment, consultancy or related nature.

(iv) The Emerging Global Financial Environment

The Forces Reshaping the Global Financial Services Industry

In developing a vision for the financial services sector in Trinidad and Tobago, cognisance must be taken of the likely evolution of the global financial services industry, which is in the midst of change. Four major forces are reshaping the world's financial services industry:

- Technological advances in computing and communications;
- Increasingly sophisticated and demanding customers;
- Rapid and pervasive regulatory reform; and
- Globalisation.

Technology

Information is at the heart of all financial transactions. It is therefore not surprising that declining information-processing costs coupled with rising computer power are having profound effects on the development and delivery of financial products and services. Simultaneously, advances in communications technology are enabling an explosion in the amount of bandwidth available to transmit increasingly vast amounts of data at minimal costs. Such advancements are allowing financial institutions to serve their customers better, faster, and in a more cost effective manner.

Most customers are accessing financial services electronically, through automated teller machines (ATMs), the telephone, the Internet, debit cards and smart cards. Transferring funds, paying bills, and checking interest rates over the telephone and the computer are readily available services at most banks. Electronic commerce is enabling customers to shop for a full range of financial and other products over the Internet. Looking ahead, electronic wallets will store electronic cash and manage transaction records. Although technology is empowering consumers as never before, there are always risks and inconveniences in a period of rapid change. In this situation, consumer protection regulation must not lag behind technological innovation and potentially abusive sales practices.

Demographic Trends

Shifting customer demographic trends are also affecting the financial services sector. Increasing life expectancy and greater pressure on public social safety nets have put greater focus on the adequacy of retirement income. With the achievement of higher education levels, customers are becoming more knowledgeable, more aware of financial product characteristics, and more comfortable with non-traditional providers. As customers become more involved in their own investment and retirement planning, they are demanding a broader range of products and services at more competitive prices, better service and through more convenient channels, including electronic channels.

The personal bonds between customers and financial institutions are weakening. Many individuals are moving their assets from traditional products such as deposits to market-based securities and mutual funds. Going forward, they are likely to take more risks by shifting a greater share of their discretionary financial assets to long-term vehicles. Financial service providers are responding to these demands by offering a menu of choices, from specialized mutual funds and stock indices to derivative-based products, like equity-linked bonds. Institutions serving the high net worth segment have also developed a wide range of exotic products.

Regulatory Reform

All major financial markets are undergoing some form of reform, which is facilitating the emergence of truly global providers by breaking down the barriers between products and countries. Pricing restrictions have been eliminated, geographic limitations and barriers to entry have fallen in most countries, and restrictions on the range of financial services that providers can offer are disappearing throughout most of North America, Europe, Asia and Australia. International trade reform efforts in financial services, for example, the General Agreement on Trade in Services (GATS), are attempts to respond to these broad forces of change.

As global players gain in skill, size and strength, these complex conglomerate groups operating across national borders increasingly challenge regulators across the world. At the best of times, they face an uneasy trade-off between the dictates of stability and competition. New forms of regulation and supervision are therefore being developed, relying to a much greater degree on international co-operation and on the effective internal governance of institutions.

Globalisation

Today, about 80 percent of the countries in the world are considered "open", and more are opening voluntarily or being forced to do so by market forces. As economies and societies become more open with easier access and lower friction in conducting business, financial services markets are becoming more global and are changing rapidly. The hallmark of a global market is a single price for the same product, in most countries of the world. By this yardstick, the foreign exchange market is truly global, money markets are almost fully global, bond markets are rapidly globalising and the globalisation of the world's equity markets has started. In essence, the world is moving toward a truly global capital market.

The Responses to Change

These forces of change create unprecedented opportunities and challenges for consumers, financial institutions, policymakers and regulators. Around the world, the boundaries separating banks, trust companies, insurance companies and securities dealers are fast disappearing. There is intense competition between mutual fund companies and deposit-taking institutions; life insurance companies are also competing for asset management business. This convergence of function has led to conglomeration, with major banks and insurance companies building full-service financial groups.

Some financial institutions are focusing on one or a few business lines and selling off activities where they feel they do not have a sustainable competitive advantage.

A third response to these changes is found in the increase in mergers and acquisitions of financial institutions taking place around the world. Within the next decade, it is likely that some significant global financial institutions will emerge.

(v) Vision of the New Financial Landscape of Trinidad and Tobago

The vision for Trinidad and Tobago is therefore to create a **Pan-Caribbean Financial Centre** that encompasses the entire group of ACS countries and is **globally competitive**, **well-diversified, responsive, and market-driven.** This Financial Centre should provide the widest possible range of financial products and services to cater for the needs of international and regional business, domestic and regional small and medium-sized enterprises and the general public and private sector. This Centre will be supported by a modern information technology architecture that delivers rapidly a high quality and cost-effective menu of financial services options to its customers. Most importantly, this Pan-Caribbean Financial Centre will be regulated by a single Regulatory Authority.

The financial architecture of this Centre would comprise of:

(i) A well-diversified range of multifaceted and flexible financial institutions which provide rapid real-time delivery of the entire spectrum of financial instruments and services, and which are well integrated with the rest of the world.

(ii) An efficient and effective payments system.

(iii) Adequate, reliable and timely information to enable borrowers and investors to monitor and diagnose financial performance and hence to allocate resources effectively.

(iv) A strong legal and prudential regulatory infrastructure that emphasizes financial soundness and stability, and the application of rules and a code of conduct that is consistent with international best practice.

(v) A modern information technology environment that enables delivery of cost effective services.

(vi) A well-educated, skilled and flexible cadre of professionals with training in finance, economics, business, accounting, law, regulation and information technology that is internationally recognised.

(vi) <u>The Role of Government</u>

The Vision for the financial sector of Trinidad and Tobago speaks to a Pan-Caribbean Financial Sector that is essentially private sector led and market driven. There is nonetheless a very critical role for the Government to play if this Vision is to be achieved.

Government's role is essentially two-fold, that of a facilitator and a developer. In its role as a facilitator, Government will be required to take a very pro-active approach to the establishment of the legal and regulatory, and institutional infrastructure as quickly as possible. This will require a dedication of resources to the various tasks at hand and a commitment to implementation within schedule.

In its role as developer, the government will participate in the market under special circumstances and conditions; in particular where the market is unable to meet particular social needs, where there are market imperfections or where there might be significant market risks.

Participation may take different forms, including the establishment and nurturing of innovative institutions, as was the case with the Trinidad and Tobago Unit Trust Corporation and the Home Mortgage Bank, or the provision of incentives to facilitate market and institutional development in specialized areas.

(vii) Recommendations

If Trinidad and Tobago is to develop a Pan-Caribbean Financial Centre which is internationally competitive and which can propel the development of the country towards the attainment of developed-country status by 2020, it will be necessary to implement the following general and sector-specific policy recommendations:

(a) General Recommendations

1. Legislative Framework: The legislative framework should be upgraded to ensure a sound legal basis for all areas of financial sector activity. This framework should encompass rules - that are in conformity with international best practice - for information disclosure, prudential requirements, mergers and acquisitions, electronic finance and standards for corporate governance, as well as rules to safeguard against money laundering and financing of terrorism. The legislative framework should also make provisions for the adoption of International Financial Reporting Standards (IFRS) after consultation with the Institute of Chartered Accountants of Trinidad and Tobago (ICATT).

2. Financial Reporting Standards: All companies that are engaged in the provision of financial products and services should be required to adopt the IFRS.

3. Regulatory and Supervisory Systems: The regulatory and supervisory systems for the various segments of the financial sector should be upgraded to provide for the integrated regulation of the sector. In order to give effect to the integrated regulation and supervision of the financial sector, a single Regulatory Authority with the necessary powers and authority should be established. As the financial reforms are gradually introduced, it may be necessary, in the interim, to establish a Regulatory Council as a first step towards the establishment of the single Regulatory Authority.

4. Regime of Taxation: The taxation regime for the financial sector should be reviewed to ensure that the sector is competitive and that tax induced distortions within the sector are removed.

5. Telecommunications Infrastructure: The telecommunications sector should be liberalized in order to keep pace with technological developments and with the provision of advanced telecommunication services at competitive prices.

6. Competition Policy: The development of a competition policy for the financial services sector should be expedited. This policy should encompass rules to deal with anti-competitive behaviour including unfair practices, rules to protect consumers, and standards to promote financial services development in the local industry while complying with international agreements.

7. Trade Agreements: There is need to ensure that commitments under bilateral, regional and international financial services agreements do not adversely inhibit the development of the financial system.

8. Financial Services Ombudsman: The Office of the Banking Ombudsman should be upgraded to that of a Financial Services Ombudsman in order to provide an alternative dispute resolution (ADR) mechanism to the formal legal system. The Office must be appropriately staffed and financially supported by the industries it serves.

9. Small Claims Court: The feasibility of establishing a "small claims court" for settling petty financial services issues that lie outside the jurisdiction of the Financial Services Ombudsman should be explored.

10. Human Resources: A cadre of human resource personnel capable of efficiently managing the financial services sector must be developed. Internationally recognised certification and accreditation requirements for persons involved in the conduct of financial business of an advisory, investment, consultancy or related nature should be instituted.

(b) Sector-Specific Recommendations

Policy Recommendations for the Banking Sector

1. Accelerate efforts to bring to Parliament the proposals to amend the Financial Institutions Act (1993) that seek to enhance supervision and strengthen the Central Bank's enforcement powers. The major provisions relate to:

    - Supervising a financial institution that is part of a group or conglomerate. The amendment should give the Central Bank:

        - Authority to enforce reporting requirements on a commercial group to which a licensee belongs.

        - Authority to institute cross-border supervision and sharing of information with other regulatory authorities.

        - Power to introduce measures to limit or restrict intra-group transactions beyond the licensee and related parties.

        - Authority to require adequate capital and other prudential requirements to be applied on a consolidated basis.

    - Cross-border supervision to allow sharing of information with foreign regulators and supervising a licensee's branch.

    - Reporting of large exposures - This would include not merely commercial loans but lending to insiders and related parties. Risk-related criteria for measuring exposure should be stipulated.

2. Facilitate the development of information vendors, an independent Credit Rating Agency, and an Automated Credit Bureau that would provide information to improve the assessment of risks.

3. Lower the statutory cash reserve requirement for commercial banks in phases to reduce intermediation costs in the banking system and bring it on par with that of the non-banks.

4. Accelerate the movement towards a market-based supervisory framework by:

   - Strengthening corporate governance and risk management capabilities that should be benchmarked against international best practice.

   - Strengthening consolidated supervision of financial conglomerates.

   - Enhancing surveillance of the financial system to provide early warning signals of potential distress.

   - Providing regular and reliable information to the public.

5. Upgrade the Inter-bank payment systems to allow for a more efficient system of payments, clearance and settlement that permits more effective oversight and management of risk.

<u>Policy Recommendations for the Capital Market</u>

1. Strengthen the legal framework governing the securities market by undertaking a comprehensive review and upgrade of the Securities Industry Act (1995) to ensure that the SEC is given effective power to regulate the capital market in accordance with internationally accepted standards. Ensure consistency among all regulations governing activities in the capital markets.

2. Modernise and consolidate the regulatory and supervisory framework in accordance with international best practice, and implement the current recommendations for reform. Specific attention should also be placed on instituting an enforceable take-over code.

3. Codify standards of good corporate governance practice in accordance with international best practice and establish rules to deal with interlocking directorates, voting rights of trustees, and management of collective investment schemes.

4. Introduce rules and regulations in support of principles-based financial reporting in line with international financial reporting standards, after consultation with ICATT.

5. Implement international standards for information disclosure and reporting so as to improve market transparency. Amend the relevant sections of the FIA 1993, the SIA 1995 and Insurance Act, Chap. 84:01 to allow for the effective sharing of information among all local regulatory authorities, as well as with other appropriate regional and international regulatory agencies in order to facilitate effective regulation of institutions operating across markets and borders.

6. Encourage greater use of equity-based financing as an alternative to debt financing.

7. Strengthen the human resource base, management information systems and institutional capacity of institutions within the sector.

8. Implement a structured programme of educating investors, regulators, self-regulatory bodies, and capital market institutions on the rights and responsibilities of all stakeholders.

9. Accelerate efforts to establish an independent Regional Credit Rating Agency.

10. Foster the development of commercial vendors of information.

11. Encourage the development of institutional relationships between the various market actors (regulators, investors, professional intermediaries and producers of services) in Trinidad and Tobago and those in regional and international financial markets.

12. Develop the microstructure of the primary and secondary market for government bonds by widening the primary distribution network for Central Government treasury bills and long-term bonds and redesigning the distribution channels for these securities. Adopt an auction mechanism as the main distribution channel for selling government securities.

<u>Policy Recommendations for the Insurance Sector</u>

1. Revise the insurance legislation and regulations in conjunction with the industry. The revisions should:

    - Provide the Regulator with the necessary powers to intervene where necessary.
    - Be appropriate for the local industry and new complex organizations that are emerging.
    - Be appropriate and in line with the Core Insurance Principles of the International Association of Insurance Supervisors which constitute current international best practice.
    - Be adequate to deal with the market conduct issues currently facing the industry.

- Require more stringent capitalization, thereby ensuring that only companies that are adequately capitalized and solvent continue operations or enter the market.

2. The Regulator should work together with ICATT and the insurance industry to develop appropriate financial reporting standards for use until such time as the International Financial Reporting Standards for insurance entities become available.

3. Review the basis on which insurance companies are taxed with a view to determining whether the existing taxation regime is fair and consistent with international best practice.

4. Enhance the supervisory system to include a more pro-active approach to risk-based supervision, improved corporate governance, and greater disclosure and information sharing with the public and other sectors of the financial system.

5. Work with national and regional regulators to place more emphasis on the sharing of information to facilitate efficiency in the regulatory process.

6. Investigate the feasibility of establishing an Insurance Fund, financed by the industry, and based on the principle of deposit insurance, to protect policyholders in the event of insolvency of an insurer.

7. Investigate the feasibility of establishing a Motor Insurance Bureau, financed by the industry, to deal with redress for victims of non-insured drivers.

Policy Recommendations for the Pension Industry

1. Consolidate and modernise, where possible and practical, the various pieces of legislation and the fragmented regulations that govern the industry.

2. Execute the regulation and supervision of pensions within an integrated regulatory framework, so as to more effectively regulate the institutions managing these funds.

3. Establish prudential criteria for the management of pension funds. These criteria should involve prudent quantitative and qualitative limits on the types of investments in which pension funds can engage, disclosure requirements buttressed by financial reporting standards, best practice, corporate governance and fiduciary standards (fit and proper management).

4. Undertake strict enforcement of prudential criteria and information disclosure requirements.

5. Codify the portability of pension rights in law so that it is not left up to the discretion of the rules of individual funds. This will ensure that fund members are not constrained or lose benefits when they switch from one pension fund to another.

6. Ensure that fund managers are capable of implementing the required prudential criteria by adopting the most up-to-date and rigorous standards for benchmarking, portfolio insurance and for measuring and limiting the risk exposures contained in the pension portfolios under their management.

7. Accelerate the harmonization and administrative integration of the Old Age Pension and National Insurance Scheme.

<u>Policy Recommendations for the Mutual Funds Industry</u>

1. Enact legislation that will provide a clearly defined regulatory and supervisory structure for the mutual funds industry. This legislation should map out licensing arrangements, corporate governance standards, disclosure requirements and capital requirements or guarantee funds, and investment guidelines, including on-line investment and investment in offshore funds.

2. Define the roles the CBTT and the SEC will play in the regulation of the mutual funds industry, or bring the regulation of the industry under the proposed single Regulatory Authority for the financial services sector.

3. Bring the operations of the UTC within the ambit of the proposed Mutual Fund Legislation.

4. Encourage fund managers to continue to develop their in-house capacity for market surveillance in order to better evaluate the significance and credibility of third party information.

5. Develop and implement new and appropriate financial reporting guidelines for market participants that are in keeping with the IFRS. This will promote transparency, foster information disclosure and provide standards for guiding decision-making by the regulatory body in determining solvency within the industry.

6. Specify effective prudential requirements for entry into the mutual funds industry.

7. Apply the “fit and proper” criteria to mutual fund managers.

8. Streamline the taxation policies within the mutual funds industry, thereby creating a level playing field for all players.

Policy Recommendations for the Credit Union Sector

1. Upgrade the legislation that governs the activities of credit unions so as to more effectively take account of international best practice in the sector as well as legislative changes in the broader financial system.

2. Draft appropriate rules for mergers and acquisitions while encouraging some degree of consolidation in the sector. Voluntary consolidation should be encouraged as the basis for creating a more competitive entity but, in cases where separate institutions cannot meet prudential standards, regulatory authorities should play a greater role in overseeing an appropriate form of consolidation.

3. Accelerate the development and implementation of relevant criteria based on appropriate prudential (such as the PEARLS ratios) and disclosure requirements and introduce systems for the continuous monitoring of credit unions. The ability of the Regulator to take decisive and appropriate action against problem institutions should also form part of this framework.

4. Improve the standard of corporate governance in the credit union sector. The process for electing officials should be addressed and fit and proper standards should be set for credit union boards, committee members and managers.

5. Retain the tax-exempt status of credit unions (at the corporate income tax level) so as to encourage the further development of the sector. This status should be reviewed every five years for relevance.

6. Supervision of the Credit Union Sector should be brought under the umbrella of the Ministry of Finance and the Central Bank.

7. Give active consideration to the graduation of the very large credit unions and credit unions that are engaging in non-core activities of a financial nature to the same standard of supervision provided for other financial institutions. Institutions to be graduated should be given a transition period to adjust to the new standards.

Policy Recommendations for the Venture Capital Industry

1. Amend the Venture Capital Act in keeping with the approved recommendations of the Task Force on Venture Capital.

(viii) <u>Implementation Plan</u>

Achievement of the vision for the financial system of Trinidad and Tobago will require development of an implementation plan that outlines the major priorities for the financial system's infrastructure and a legislative agenda, supported by an effective implementation schedule. This section outlines the institutional development, legislative agenda, and implementation schedule that are necessary to lay the foundation for the establishment of a Pan-Caribbean Financial Centre.

Development of the Institutional Infrastructure

In order to improve the efficiency of the operations of the financial system, several changes will need to be made to the existing financial services infrastructure. In the short to medium term, the most important of these will comprise the establishment of a Financial Services Ombudsman, a Credit Rating Agency, an Automated Credit Bureau, a Regulatory Council, a single Regulatory Authority and the upgrade of the National Payments System.

Establishment of the Office of a Financial Services Ombudsman

The Office of the Banking Services Ombudsman was established in May 2003 to facilitate independent and prompt resolution of complaints raised by customers of commercial banks. Over the course of time, the responsibilities of this Office will be extended to other activities in the financial services industry.

Establishment of a Regional Credit Rating Agency

The Central Bank of Trinidad and Tobago, local commercial banks and other financial institutions that operate in the local and regional market have collaborated to establish a Credit Rating Agency. This agency is expected to be functional before the end of 2004.

The prime objective of the Credit Rating Agency would be to improve the availability and quality of credit information on governments and firms raising capital from financial markets. It is expected to foster greater development of capital markets and the investment climate in Trinidad and Tobago by enhancing access to financial markets and by improving the pricing of capital market placements.

Establishment of an Automated Credit Bureau

The Bankers Association of Trinidad and Tobago is expected to introduce an Automated Credit Bureau in early 2004. This initiative falls within the context of the Secured Transactions Project sponsored by the Multilateral Investment Fund of the IADB, which has as its main objective the establishment of an efficient legal and institutional framework for secured transactions to improve and broaden access to credit services, specifically for small and medium-sized enterprises. The Credit Bureau is expected to maintain a database of information on consumer credit in the financial system and to compile reports on the creditworthiness of individuals. This should reduce credit risk, encourage lower transaction costs for lenders, improve credit terms for borrowers and encourage competitive lending practices.

Draft legislation, the Consumer Fair Reporting Bill, which provides for the Central Bank to be the licensing authority for credit bureaus under the proposed legislation, has been circulated to relevant parties for comment.

Establishment of a Regulatory Council and a Single Regulatory Authority

At the present time, none of the Regulators of the financial sector have the legal authority to co-operate and share information. The first step in achieving this involves the regulators in the industry developing an operational framework for creating an appropriate information sharing mechanism.

A Council of Regulators will be established by the end of December 2004 for the purposes of minimizing and managing systemic risks and ensuring stability of the financial system. An initial meeting has been held and draft Terms of Reference are being formulated.

The Council will also ensure that appropriate Memoranda of Understanding are executed when the amendments are made to the various financial legislations; thereby giving each Regulator the legal power to share information.

The Council will also prepare a Draft Paper for Establishing the Single Regulatory Authority with the necessary powers of authority to give effect to full integrated supervision.

Establishment of a National Payments System

An efficient domestic payments system, with proven modern technologies, that services the needs of the domestic financial system, but which also has the potential to link to international payments systems, is indispensable for the development of financial services in Trinidad and Tobago. Recognising the need for providing users with a range of options for making payments, reducing the cost of financial transactions and enhancing the smooth functioning of the financial sector, the Central Bank of Trinidad and Tobago has initiated a project to reform the payments clearance and settlement systems. This reform is aimed at minimizing systemic risks and ensuring that there are modern, fast and accurate tools to manage liquidity and monitor the behaviour of the payments system.

The overall reform involves a number of activities that will be performed by the Central Bank and other participants in the system. The Central Bank will undertake the development of (i) the Real Time Gross Settlement System (RTGS), (ii) the Government Securities Depository (GSD) and (iii) the Inter-bank Funds Trading System. The other components of the Strategic Payments Architecture are (i) the Automated Clearing House (ACH) which is being managed by the ACH Project Review Committee, comprising the CBTT and all the commercial banks, (ii) the Stock Exchange Trading System which is being implemented by the Stock Exchange, (iii) the Central Securities Depository which recently began operations as the TTCD, (iv) other payments systems, (currently LINX and the credit card system) and (v) clearing houses.

These systems would need to be continuously upgraded to take advantage of new technologies as well as to permit consumers and investors, where appropriate, access to on-line services.

(ix) <u>Legislative Agenda</u>

In order to give effect to the recommendations for reform of the financial system so that implementation can be achieved in a reasonable time period, several legislative priorities have been established. This section explores the major legislative priorities for each of the sub-sectors of the financial system.

Banking

<u>Objective of Legislation</u>

A detailed Legislative Drafting Brief to amend the Financial Institutions Act, 1993 was prepared by the Central Bank in 2000 and circulated to the banking industry for comment. The legislation is being amended to bring it fully in line with the Core Principles of Effective Banking Supervision as set out by the Basle Committee on Banking Supervision and to ensure consistency with international best practice. The Central Bank's objective is to procure the amendments to the FIA by June 2005.

<u>Core Principles and Amendments</u>

The proposed legislation will, among other things, seek to empower the Central Bank to:

- Conduct effective consolidated and cross-border supervision.
- Share information with other domestic and foreign regulatory bodies.
- Access information from affiliates of licensed institutions.
- Regulate holding companies whose concept will be re-defined under the proposed amendment to the FIA.
- Require licensed institutions ("licensees") to seek the prior approval of the Central Bank to acquire substantial controlling interests in another company (subsidiaries).
- Deal with licensees that though fully compliant with the legislation, are not financially strong and are experiencing liquidity and other difficulties.
- Impose civil money penalties on licensees for breaching certain provisions of the FIA.

National Payments System

Objective of Legislation

The proposed legislation seeks to establish a legal environment that will support a modern, sound and efficient national payments clearance and settlement system in Trinidad and Tobago. The payments system will also be governed by specific agreements among the system's participants. An appropriate professional assessment of the enforceability of these arrangements is being undertaken.

Core Principles and Amendments

The legislation will be developed to provide more complete regulation by the Central Bank of the payments clearance and settlement system and will address issues related to:

- The Payments System oversight function.
- Improvement of the Payment Clearance and Settlement System.
- Finality and irrevocability of payments.
- Interrelations with insolvency laws and procedures.
- Transparency and access criteria.
- Electronic transfers.

Capital Market

Objective of Legislation

The review of the SIA, 1995 and its by-laws and associated legislation is intended to bring the securities regulatory regime in Trinidad and Tobago to the level of international best practice.

Core Principles and Amendments

Several conceptual and structural changes for securities regulation in Trinidad and Tobago have been recommended. These include:

- The evolution of securities regulation from issuer-based jurisdiction to investor-based and activity-based jurisdiction.
- Separation of the policy-making enforcement and adjudicative functions of the securities regulatory authorities.
- Provision for the Securities Market Tribunal and the suggested amendments to the Companies Act Chap. 81:03 that places "public company" regulation under the supervision of the SEC.

- Treating with competing concerns, which include the emerging state of the securities market, the need to balance market development with investor protection, the expertise and resources available in securities regulation and related fields, and the need for a level playing field among the securities market participants.

- Establishment of By-Laws for Collective Investment Schemes with a mixed disclosure approach and substantive regulation approach.

Insurance

Objective of Legislation

The central objective of the proposed amendments to the Insurance Act is to modernize the insurance sector in line with international best practice by ensuring adequate and appropriate prudential international standards for supervision and regulation of the insurance industry and pension plans.

Core Principles and Amendments

The Core Principles of the proposed legislation are intended to:

- Strengthen the capacity and capability of the regulatory agency to address the complex issues that have developed in the insurance business and mitigate the weaknesses that now afflict the Supervisor's Office.

- Improve the regulatory framework to bring it in line with market imperatives and developments relative to product innovation and corporate restructuring.

- Incorporate current international standards as espoused by the International Association of Insurance Supervisors (IAIS). These regulatory principles have been internationally recognized as being necessary for effective supervision of insurers as well as for providing mechanisms to monitor international operations and cross-border activities. Adherence to these standards also promotes international regulatory consistency, which is an important element in effectively regulating cross-border activity.

- Remove the legislative mechanisms incorporated in the Insurance Act to allow the regulator to act in an appropriately expeditious manner and effectively deal with current weak companies to either restore financial capacity or manage an exit policy.

- Apply consistent regulatory methods and systems to financial services and products and thus eliminate requirements and standards that discriminate between them. This will promote fairness in the market and also reduce opportunities for regulatory arbitrage.

- Reduce systemic risks in the financial system by affording an increased span of control by one regulator over a larger segment of the financial sector.

Among the key areas to be covered by the legislation are licensing of companies; prudential standards; corporate governance; related party transactions; market conduct including consumer protection; corporate transactions (mergers, transfers of business, etc.); financial reporting and records; and the powers of the Supervisor.

Pensions

Objective of Legislation

The proposed new pension legislation is intended to modernize the pension industry by developing and implementing a comprehensive pension regime for Trinidad and Tobago.

Core Principles and Amendments

The proposed new legislation, which will accompany the reformed pension regime, will address a number of core issues in the industry, including:

- Consolidation and modernization of the various pieces of dated legislation.
- Integrated regulation and supervision of the industry.
- Administrative integration of the National Insurance Scheme (NIS) and Old Age Pension (OAP).
- Provisions for the establishment of minimum requirements/benchmarks governing the operations of the industry, including:
    - Portability and transferability.
    - Prudential criteria for the management of pension funds.
    - Fit and proper criteria for fund managers and trustees.
    - Entry and exit criteria.
    - Corporate governance.
    - Reporting requirements.
    - Information disclosure.
    - Financial reporting standards.
- Establish, in consultation with the industry and relevant stakeholders, core principles regarding:
    - Indexation of benefits and contributions.
    - Minimum income replacement ratios.
    - Minimum guaranteed levels of income maintenance in retirement.
    - Treatment of pension funds surpluses and deficits.

Credit Unions

Objective of Legislation

The reform of the Credit Union sector seeks to advance the operations and processes of the sector by bringing it in line with international best practice thereby creating developed, modern and stable institutions that will help to strengthen the financial system of Trinidad and Tobago. The Co-operatives Societies Act, Chap. 81:03, which governs the credit union sector, is outdated and does not effectively address the stability of the sector.

Core Principles and Amendments

The proposed new legislation will focus on the following key issues:

- Consolidate and revamp the existing regulatory and supervisory authorities for credit unions.

- Require the preparation of financial statements in accordance with the IFRS.

- Develop and implement relevant criteria with minimum standards for:

    - Mergers and acquisitions.
    - Information disclosure.
    - Financial reporting standards.
    - Corporate governance.
    - Mechanisms for assessing credit-worthiness and risks.
    - Fit and proper criteria for key management and directors.

Venture Capital

Objective of Legislation

In August 2003, Cabinet approved the recommendations of the Task Force on Venture Capital, which seek to amend the Venture Capital Act, 1994. The Chief Parliamentary Counsel (CPC) has prepared draft amendments to the legislation. The principal objective of the amendments is to improve the effectiveness of the venture capital regime.

Core Principles and Amendments

The proposed amendments to the legislation will address the following critical issues:

- Increasing the range of investment instruments in which venture capital companies may invest.

- Removal of the restrictions on the type of shares that could be issued by venture capital companies.

- Removal of the residentiary requirements of directors.

- Inclusion of fit and proper requirements for fund managers.

- Increasing the equity share capital of venture capital companies.

- Deletion of the minimum capital requirement.

- Amendment of the ratio of investment requirements from 50% by the end of the second year to 75% by the end of the fourth year.

- Deleting the categories of business involving primary resource extraction (including oil and natural gas extraction) and the manufacture of petrochemicals from the list of prohibited categories of investment.

- Removal of the restriction on the size of a Qualifying Investee Company (QIC) and increasing the limit on the issued capital of a QIC from TT$3 million to TT$50 million.

(x) Implementation Schedule

The implementation schedule identifies priority dates by which activities should be completed if effective modernization of the financial services industry is to be achieved.

Implementation Schedule for Activities in the Financial Sector

Task Name	End Date	Implementing Agency
All Sectors		
Create Office of Financial Services Ombudsman	DEC 2004	**CBTT**
Establish an Interim Regulatory Council	DEC 2004	**CBTT**
Establish a Single Regulatory Authority	DEC 2006	**CBTT**
Banking Sector		
Commence Operations of the CRA	OCT 2004	**CARICRA/CBTT**
Commence Operations of the ACB	OCT 2004	**CBTT/BATT**
Reduce Statutory Cash Reserves Requirement for Commercial Banks	MAR 2005	**CBTT**
Amend the FIA 1993	JUN 2005	**CBTT**
Upgrade Inter-Bank Payment Systems	MAR 2006	**CBTT**
Capital Market		
Foster Development of Commercial Vendors of Information	JUN 2004	**SEC**
Commence Electronic Trading on the Stock Exchange	SEP 2004	**SEC**
Review and Upgrade SIA, 1995	APR 2005	**SEC**
Modernize the Regulatory and Supervisory Framework	JUN 2005	**SEC**
Strengthen the SEC	AUG 2005	**SEC**
Improve Standards for Good Corporate Governance	DEC 2005	**SEC**
Develop the Micro-structure of Market for Government Bonds	DEC 2005	**SEC**
Develop Institutional Relationships among Market Actors	DEC 2005	**SEC**
Enhance Investor Education Programme	ONGOING	**SEC**
Insurance Sector		
Investigate the Feasibility of Establishing an Insurance Fund	MAR 2005	**CBTT/ATTIC/ MOF**
Investigate the Feasibility of Establishing a Motor Insurance Bureau	MAR 2005	**CBTT/ATTIC/ MOF**
Implement Appropriate IFRS in Consultation with ICATT	JUN 2005	**ICATT/CBTT/ ATTIC**
Review Current System of Taxation	JUN 2005	**MOF/CBTT**
Implementation of Modern Supervisory Practices	DEC 2005	**CBTT**
Procure Comprehensive Amendments to the Insurance Act	DEC 2005	**CBTT/MOF**

Implementation Schedule for Activities in the Financial Sector cont'd

Task Name	End Date	Implementing Agency
Pensions Industry		
Develop Prudential Criteria for the Management of Pension Funds	DEC 2004	**CBTT**
Enforce Information Disclosure Requirements	DEC 2004	**CBTT**
Consolidate and Modernise Pension Legislation	DEC 2005	**MOF**
Codify the Portability of Pension Rights in Law	DEC 2005	**MOF**
Establish the Integrated Regulatory Framework	DEC 2005	**MOF/CBTT**
Harmonize and Integrate the OAP and NIS	DEC 2005	**MOF**
Mutual Funds Industry		
Incorporate Effective Financial Reporting Standards in the Regulatory & Supervisory Framework for Mutual Funds	APR 2005	**SEC**
Develop Investment/Mutual Funds Legislation	NOV 2005	**SEC**
Develop Capacity for Market Surveillance	NOV 2005	**SEC**
Credit Union Sector		
Draft Rules for Mergers and Acquisitions	DEC 2004	**MOF**
Transfer Supervisory Authority to MOF/CBTT	JAN 2005	**MOF/CBTT**
Develop Prudential Standards for CUs	JUN 2005	**MOF**
Improve Standards of Corporate Governance	JUN 2005	**MOF**
Review the Principle of Graduation of CUs	JUN 2005	**MOF**
Upgrade Legislation Governing CUs	OCT 2005	**MOF**
Venture Capital Industry		
Amend the Venture Capital Legislation	JUN 2004	**MTI/MOF**

ACB - Automated Credit Bureau
ATTIC - Association of Trinidad and Tobago Insurance Companies
BATT - Banker's Association of Trinidad and Tobago
CARICRA - Caribbean Credit Rating Agency
CBTT - Central Bank of Trinidad and Tobago
CPC - Chief Parliamentary Counsel
CRA - Credit Rating Agency
ICATT - Institute of Chartered Accountants of Trinidad and Tobago
MOF - Ministry of Finance
MTI - Ministry of Trade and Industry
SEC - Trinidad and Tobago Securities and Exchange Commission

SECTION 1.0: VISION FOR THE ECONOMY OF TRINIDAD AND TOBAGO

1.1 The Existing Macroeconomic Environment

Over the last decade, Trinidad and Tobago has been enjoying an uninterrupted period of positive economic growth, led by the energy sector. The macro-economy has been generally characterised by **low inflation, a stable exchange rate, a healthy foreign reserves position and a declining rate of unemployment** (Table 1.1). Since the second half of 2001, the economy has weathered the global and regional slowdown relatively well.

Medium-term prospects for Trinidad and Tobago appear quite strong. The anticipated doubling in the combined real output of oil and natural gas between 2002 and 2006 will support growth in the production of ammonia, methanol and LNG and should generate sizeable external current account surpluses and foreign exchange earnings. This strong expansion in the energy sector is also expected to generate additional demand in key non-energy sectors – construction, manufacturing and financial services. In the near to medium term, **real GDP** is expected to grow on average by between **4-6 percent**, peaking in 2005 at about 9 percent when the new gas projects come on stream.

The emphasis on the energy sector, however, exposes the economy to external price and demand shocks and it remains particularly sensitive to business cycles in its major export markets, especially the United States, the Caribbean region and Europe.

Table 1.1: SELECTED ECONOMIC INDICATORS, 1993 - 1994 and 1998– 2003

ITEM	1993	1994	1998	1999	2000	2001[r]	2002[r]	2003[p]
Nominal GDP ($M)	24,490.5	29,311.7	38,065.1	42,889.1	51,370.6[r]	55,009.1[r]	59,486.9[r]	67,692.2
Energy	*5,696.7*	*8,760.6*	*7,027.5*	*9,635.4*	*16,072.8*[r]	*16,434.2*[r]	*17,268.6*[r]	*21,237.3*
Non-energy	*18,793.8*	*20,551.1*	*31,037.6*	*33,253.8*	*35,297.8*[r]	*38,574.9*[r]	*42,218.3*[r]	*46,454.9*
Origin of GDP				(In per cent of GDP)				
Energy	**23.3**	**29.9**	**18.5**	**22.5**	**31.3**	**29.9**	**29.0**	**31.4**
Non-energy	**76.7**	**70.1**	**81.5**	**77.5**	**68.7**	**70.1**	**71.0**	**68.6**
Agriculture	3.2	3.2	2.1	1.9	2.0	1.8	1.7	1.7
Manufacturing	11.8	11.1	9.1	8.0	10.3	10.2	10.1	10.0
Construction	10.1	10.9	8.7	8.1	10.9	11.5	10.7	11.5
Financial Services	16.9	17.6	14.7	14.8	20.7	22.0	23.5	23.5
Other	34.7	37.3	46.9	44.7	24.8	24.6	25.0	21.9
National Income and prices				(Annual percentage changes)				
Real GDP (1985=100)	-2.6	5.0	4.6	5.8	5.7	4.1	2.7	3.4[1]
Energy	**-7.1**	**8.2**	**5.4**	**8.1**	**1.1**	**0.7**	**10.6**	**12.6**[1]
Non-energy	**-1.1**	**3.9**	**4.4**	**5.1**	**7.2**	**4.9**	**0.5**	**0.6**
Agriculture	-10.8	10.8	-10.7	12.0	9.5	-3.7	5.5	-17.9
Manufacturing	-2.9	2.5	4.1	3.4	6.7	4.7	-0.9	1.4
Construction	-6.1	3.3	13.9	7.9	8.0	4.9	5.0	3.8
Financial Services	3.3	0.9	2.5	2.2	2.4	2.8	2.3	-0.4
Inflation Rate (%)								
(period average)	10.8	8.8	5.6	3.4	3.6	5.5	4.2	3.9[2]
(end of period)	13.5	5.2	5.6	3.4	5.6	3.2	4.3	3.0[2]
Unemployment Rate (%)	19.8	18.4	14.2	13.1	12.2	10.8	10.4	10.3[2]
				(In per cent of GDP)				
Overall Central Government Surplus(+)/Deficit(-)[3]	-0.2	0.0	-2.3	-2.2	-0.2	1.6	-0.2	1.4

Table 1.1: SELECTED ECONOMIC INDICATORS, 1993 - 1994 and 1998– 2003, cont'd

ITEM	1993	1994	1998	1999	2000	2001[r]	2002[r]	2003[p]
Balance of Payments								
Merchandise Exports	36.2	39.5	37.0	41.5	52.4	48.5	40.9	47.8
Merchandise Imports	32.7	27.5	49.1	40.5	40.5	40.4	38.4	37.2
Current Account	-2.4	4.4	-10.5	0.5	6.6	4.7	3.2	8.1
External Public Debt (US$M)	2,102.1	2,063.5	1,471.1	1,584.8	1,679.8	1,637.6	1,595.7	1,558.0
Debt Service Ratio (%)[4]	30.3	25.2	9.9	8.0	6.9	3.7	4.3	4.1[e]
W.T.I. (US$/barrel)	18.45	17.14	14.40	19.25	30.29	26.09	26.03	31.18
Gross Official Reserves (US$M)	231.8	354.4	783.3	967.6	1,405.5	1,876.0	1,923.5	2,257.7
Exchange Rate (TT$/US$)[5]	5.34	5.87	6.28	6.28	6.27	6.20	6.21	6.26

Source: Central Bank of Trinidad and Tobago

[1] These percentage changes represent data from January-September 2003 on a year-on-year basis.
[2] As at September 2003
[3] In 1998, the government's financial year which previously coincided with the calendar year was changed to the twelve month period between October 1 and September 30. Consequently the 1998 fiscal year was shortened to January – September 1998.
[4] This is defined as the ratio of external public sector debt service to exports of goods and non-factor services
[5] This rate represents the mid-point of the period average of the buying and selling rates of the TT/US dollar.
r - revised

1.2 The Economy of Trinidad and Tobago: A Vision for the Future

With a per capita income of US$7,921 in 2003, Trinidad and Tobago is classified as a middle-income developing country. Although the country has made considerable strides in the last two decades to become one of the wealthier and progressive countries in the Caribbean, much work still has to be done to achieve the status of a developed country. Indeed, the Government of Trinidad and Tobago has identified the achievement of developed-country status by the year 2020 as the principal developmental goal of the nation. Such an undertaking will require some considerable effort, but is absolutely vital if the quality of life of its citizens is to be improved.

The attainment of the status of developed country will require sustained and strong economic growth over the course of the next two decades. These increases in real output need to be accompanied by prudent macro economic policy management geared towards a low rate of inflation and unemployment. To maintain this acceleration, it will be necessary to establish a flexible and vibrant economic structure that can generate a level of savings and investment that will sustain the regeneration of the productive structures and processes in the country. There will also be a need to diversify the economy further to avoid over-dependence on the energy sector. The economy will also have to become more flexible and competitive so that its productive and human resources can be reorganized 'at short notice' to take advantage of changing trends in world demand.

Education and health are critical elements in the thrust towards the achievement of developed-nation status. They are vital to the development of the human capital base, which is of paramount importance in fostering a competitive and productive society. The education system will have to address the needs of the economy of the future - the knowledge economy - and must be accessible to all citizens, at all levels, from primary to tertiary. This would require a gross tertiary enrolment rate in excess of 50 per cent. Concomitant with the improvements in education, the country will need to improve the overall standard of health care; high quality health care will need to be made available to all citizens at an affordable cost in order to guarantee the continuous productivity of the human resources of the nation. The improvements in educational opportunity, quality health care and gainful employment opportunities should serve in the medium to long term to reduce the incidence of crime and eradicate poverty.

There are also substantial economic gains to be derived from improving the role of institutions, including the public sector, the legal system, labour markets, social insurance mechanisms and financial markets, among others.

It is worth emphasizing that the development of a flexible, vibrant and diversified economy, which can respond adequately to changes in the international environment, is a key requirement for sustainable development of the country. The economy must therefore become competitive in a range of activities in both the energy and non-energy sectors.

SECTION 2.0 ***THE EXISTING FINANCIAL LANDSCAPE OF TRINIDAD AND TOBAGO***

2.1 Background

For the past forty years, the financial sector has been responding to a constantly changing macroeconomic environment and has made some significant strides, especially over the past ten years. In the decade of the 1960s, a relatively underdeveloped financial system emerged, with a limited range of institutions and instruments to service an economy that was just breaking away from the vestiges of colonialism. The Central Bank and foreign commercial banks were the major financial players and cash and demand deposits were the main financial instruments. The increase in the price of oil in the 1970s boosted economic growth significantly and led to an economy dominated by the petroleum sector.

In the 1980s, the Government of the Republic of Trinidad and Tobago embarked on a plan of financial sector development that was aimed primarily at facilitating the broadest possible participation in the country's economic development through participation in the money and capital markets. Non-national companies were encouraged to register locally and to sell part of their equity to domestic residents. The demands of a rapidly growing economy led to the development of several non-bank financial institutions and an expansion in the range of instruments in the financial system. A number of new financial institutions were developed to support the policy objective of broadening public participation: in particular, the Home Mortgage Bank, the Deposit Insurance Corporation, the Trinidad and Tobago Unit Trust Corporation, and the Stock Exchange. Although commercial banks still account for 42% of the institutional assets of the financial system, there has been some significant growth in non-bank financial institutions (Tables 2.1 and 2.2).

Since the onset of financial liberalization in the first half of the 1990s, the complexity of the financial system has grown, especially with increased alliances between banks and insurance companies. Many financial conglomerates have emerged and have been diversifying their business product range in both the domestic and regional financial markets.

The increasing importance of large financial institutions in Trinidad and Tobago, which offer multiple financial products and services, poses new challenges for regulation. In particular, it raises issues of potential contagion and the management of systemic and liquidity risks.

Although the cross-country exposure of Trinidad and Tobago's financial sector to the Caribbean has been rising, it is still relatively small in relation to the total assets of the domestic financial system. Nonetheless, there is need to pay closer attention to the portfolios of those financial institutions that have direct exposure to the Caribbean region.

The rapid integration of these financial markets will greatly increase the potential for a financial crisis to not only spread across regional and international borders, but also to contaminate the national financial system.

The process of trade and financial liberalization along with developments in technology are impacting on the nature of competition in the financial sector. Increasingly, foreign entities are able to attract business from the local market, through suitcase trading, money transfers and Internet-based transactions. Moreover, a process of dis-intermediation is taking place, where firms in the non-financial sector, for example, furniture and appliance stores, are extending and managing credit without reference to financial institutions. These developments have the effect of creating a more competitive environment through which financial intermediation is taking place.

Table 2.1: Financial System Institutional Composition of Assets, Selected Years

($MN)

Type of Institution	**1966**	**1975**	**1980**	**1985**	**1990**	**1995**	**1999**	**2001**	**2002**
Central Bank	73.3	1994.3	7188.6	5578.2	7010.6	7646	8556	12481	15591.7
Commercial Banks	300.5	1555.9	5215.9	10165.1	12178.2	20053.6	26474	32933.1	38136.8
Finance Companies & Merchant Banks	n.a.	79.6	485.3	1235.1	1172.3	2090.3	4014	4791.5	6251.2
Trust & Mortgage Finance Companies	n.a.	158.7.	654.7	1856.4	1823.1	3740	4890	9159.3	8906.5
Development Banks	4.1	73.9	297.3	980.4	1075.6	993	1009	1349	1326.9
Credit Unions	13.1	52.7	210.5	695.3	1722.4	2500	2800	2837.6	NA
Insurance Companies	-	362.1	806.1	2033.6	3685.8	5462.2	8500	NA	NA
Thrift Institutions	9.8	42	60.2	91.7	102.2	78.5	81	75.3	62.6
National Insurance Board	-	149.9	530	1570	2413.8	3284	4795	6396.9	7184.5
Stock Exchange	-	-	-	0.8	2.6	8.9	18.3	19.3	22.4
Unit Trust Corporation	-	-	-	21.3	335	1316	2826	4420.4	5579.2
Deposit Insurance Corporations	-	-	-	-	66.5	193	318	430.6	515.1
Home Mortgage Banks	-	-	-	-	283	656	773	837.2	885.9
Trinidad & Tobago Mortgage Finance					1.075	1.004	1.12	1.326	1.406
Total	**400.8**	**4419.1**	**15448.6**	**24227.9**	**31871.1**	**48021.5**	**65054.3**	NA	NA

Source: Audited Statements, Annual Reports, Central Bank of Trinidad and Tobago

* Data for all institutions refer to December 31 with the exception of those for NIB and the DIC, which refer to June 30 and September 30 respectively.

Table 2.2: Number of Existing Financial Institutions, Selected Years

Type of Institution	1966	1975	1980	1985	1990	1995	1999	2000	2001	2002	2003
Central Banks	1	1	1	1	1	1	1	1	1	1	1
Commercial Banks	7	9	9	8	8	6	6	6	6	6	6
Finance Companies & Merchant Banks	2	7	12	14	12	10	10	9	9	10	10
Trust & Mortgage Finance Companies	3	5	7	8	7	6	6	5	5	5	5
Development Banks	2	3	3	3	3	2	2	2	2	2	2
Credit Unions	312	284	420	381	400	398	390	NA	NA	NA	NA
Insurance Companies	-	57	60	57	56	58	49	47	47	47	47
Thrift Institutions	-	4	4	4	4	4	4	-	3	3	3
National Insurance Board	-	1	1	1	1	1	1	1	1	1	1
Stock Exchanges	-	-	-	1	1	1	1	1	1	1	1
Unit Trust Corporation	-	-	-	1	1	1	1	1	1	1	1
Export Credit Insurance	-	1	1	1	1	1	1	1	1	1	1
Reinsurance Companies	-	-	-	1	1	1	-	-	-	-	-
Deposit Insurance Corporations	-	-	-	-	1	1	1	1	1	1	1
Home Mortgage Banks	-	-	-	-	1	1	1	1	1	1	1
Venture Capital Companies	-	-	-	-	-	-	2	3	2	2	2
Total	327	372	519	481	498	476	471	NA	NA	NA	NA

Source: Central Bank of Trinidad and Tobago

2.2 Diagnostic of the Financial System in Trinidad and Tobago

2.2.1 The Banking Sector

Architecture of the Banking Sector

At present there are six commercial banks operating in Trinidad and Tobago with an extensive network of 123 branches. Two of the banks are wholly foreign-owned while the remaining banks are either partly or completely owned by nationals. The commercial banks remain the single largest group of financial institutions in terms of assets, but they have lost ground to the rest of the financial system. Two of the locally owned banks have established a commercial presence in various territories in the Caribbean.

There has been considerable growth in the use of ATMs for the provision of banking services, and there are now 254 ATMs in the country (an average of 1 ATM per 5000 persons). Banks have also been providing telephone and Internet banking services. Four banks share a linked network of ATMs and debit point-of-sale operations.

Banks now offer a relatively sophisticated menu of services. There is some blurring of the distinction between banks and non-banks and many banks offer a variety of innovative financial products, including retirement plans denominated in US currency, individual annuity plans, and mutual funds including offshore equity funds. Banks are also playing a central role in the development of the money market.

The Financial Institutions Act (1993), which is currently under review, regulates the commercial banking sector. The proposed amendments seek to enhance supervision and strengthen the enforcement powers of the Central Bank, especially with respect to cross border supervision and the supervision of financial institutions that are part of a group or conglomerate.

Performance of the Banking Sector

Growth

Over the last five years the growth of assets and deposits in the banking sector has averaged between 9 and 11 per cent and has remained relatively stable. However, the proportion of loans in the asset portfolio of banks has been low (40 per cent), relative to that in OECD countries (52 per cent to 66 per cent). Although banks have been gradually moving away from interest-earning activities towards fee income and investments (Table 2.3), interest income remains the most significant source of operating income, despite its decline in importance relative to fee income and investments.

Table 2.3: Selected Sources of Income of Commercial Banks, Selected Years (Percentage)

	1990	1995	1999	2002
Interest on Loans	75.2	54.7	57.6	46.5
Interest on Investments	7.5	15.7	15.2	18.7
Service Fees	4.2	11.3	10.3	13.9

Source: Central Bank of Trinidad and Tobago

Since the restructuring of three troubled banks in 1993, the banking system has been characterized by relative stability. Domestic banks have enjoyed moderate profitability compared to their counterparts in the advanced industrialised countries, although their levels of operating efficiency have been comparatively lower (Table 2.4).

Current financial indicators for the banking sector suggest that the system is relatively well capitalized; the share of non-performing loans has fallen to under 4 percent of total loans; loan provisioning has been increasing and profitability and efficiency ratios have also improved. The banking sector therefore appears to be generally sound.

Table 2.4: Profitability and Efficiency of Commercial Banks, 1997-1999 (Average Percentage)

	Trinidad and Tobago	Germany	Japan	United Kingdom	United States
Return on Assets	2.0	0.5	-0.3	1.2	1.8
Operating Cost to Income	76.5	63.2	75.1	57.1	61.5

Sources: Central Bank of Trinidad and Tobago.
OECD Publication: Bank Profitability: Financial Statements of Banks 2000 edition.

Major Weaknesses in the Banking Sector

Credit Allocation

From a macro-economic perspective, the quality of credit allocation is critical to the attainment of economic growth and credit policy therefore needs to be consistent with a sustainable growth objective. Typically, the consumer sector tends to be the largest single sector receiving credit. Ideally, however, the bulk of credit should be extended to financing sectors of strategic importance. Some progress has been achieved recently, since banks now allocate a greater proportion of credit to the business rather than to the consumer sector. However, one important aspect of the challenge confronting financial authorities is to develop market mechanisms to allocate a more significant proportion of credit to sectors of strategic importance.

Interest Rate Spreads

The magnitude of interest rate spreads remains an issue of some concern in a competitive financial environment. Interest rate spreads in Trinidad and Tobago have widened, compared to the era preceding currency liberalization. Much of the increase can be attributed to higher cash reserve requirements and higher fixed costs, the latter suggesting that banks may not have taken full advantage of economies of scale.

Reserve Requirement

Until 1996, when the Central Bank moved to open market operations, the principal tool of monetary policy was the cash reserve requirement, which is unremunerated. As a result, the reserve requirement helped to raise the cost of funding for banks and contributed to a widening of the interest rate spread. Currently, commercial banks, trust and mortgage companies, and finance houses are subject to varying reserve requirements, whereas institutions not supervised by the Central Bank are not subject to any such requirements. These differences in reserve requirements have caused distortions, especially in an environment where the distinction between banks and non-banks is being eroded.

In October 2003, the Central Bank signalled its intention to gradually lower the cash reserve requirement for banks from 18 percent to 9 percent over a period of one and a half years, to bring it on par with the non-banks. Thus far, the reserve requirement has been reduced to 14 percent.

Consumer and Investor Protection

The issue of consumer and investor protection has gained increased prominence because of the problems of fraud, misuse of funds, inadequate provision of information to clients and unauthorized sharing of confidential information. Additionally, the timely settlement of disputes is becoming more important, since settlement via the courts is expensive and often involves long delays. To address these issues, a Banking Services Ombudsman has been appointed.

Challenges and Opportunities for the Banking Sector

Market Penetration

Local commercial banks have gained valuable experience from expanding and operating within the CARICOM region. However, a long-term challenge for the sector is to penetrate extra-regional markets, such as those of the United States, Canada, and the United Kingdom. Local commercial banks may face reputational barriers as well as higher capital and solvency requirements in the more established global financial centres. The banks will have to develop more creative mechanisms, given the extent of competition and the regulatory complexities involved. The negotiations at the GATS can play a crucial role in penetrating markets.

Market Entry

Trinidad and Tobago has not made a commitment in the GATS to further liberalise its banking sector. Although entry into the domestic sector is fairly liberal, the entry of foreign competitors has been slow as foreign competitors consolidate their operations in their home markets and pursue large markets. Moreover, the number of local commercial banks has remained fairly stable as penetration has proven difficult, particularly because of the period of learning required, and the disadvantage new entrants are likely to have in attracting customers from banks with already established brand names.

2.2.2 The Capital Market

Structure of the Capital Market

The main capital market institutions in Trinidad and Tobago are the Trinidad and Tobago Securities and Exchange Commission, the Trinidad and Tobago Stock Exchange, merchant banks, and a number of brokerage firms engaged in the sale of equities and bonds. The inability of the capital market in Trinidad and Tobago to mobilise and allocate financial resources efficiently is the direct result of the underdeveloped microstructure of the market. The market is relatively fragmented and thin in terms of the array of instruments and the number of firms and investors that participate in market activity, when compared to other emerging markets in developing countries.

Performance of the Capital Market

The Bond Market

Public sector bonds are the dominant instruments in the primary market and are issued by state-owned and state-controlled entities. The involvement of private sector corporations in the primary bond market is relatively limited. Over the last five years, regional governments, in particular the member states of the Organisation of Eastern Caribbean States (OECS), have bolstered the activities in the primary bond market in Trinidad and Tobago.

A significant proportion of the bonds issued by the Central Government have been undertaken through private placements. Over the last 4 years, there have been no public issues of central government bonds. An estimated 60 percent of the bonds issued by the Central Government are floating-rate coupon bonds, although in the last two years, there have been a number of fixed-rate coupon issues.

The secondary bond market is relatively thin and trading in bonds occurs infrequently because of the lack of an ample supply of bonds as well as regulatory requirements for institutional investors. Institutional investors such as insurance companies, pension funds and social security providers are encouraged to hold a stipulated proportion of their assets in government bonds, thereby placing a high premium on government bonds.

Equities

The TTSE commenced trading in stocks on October 26, 1981 with a total market capitalisation of TT$2,291.5 million, eight (8) brokerage houses and thirty-five (35) listed companies. Two decades later, the institutional characteristics of the market, as well as trading patterns, have remained relatively unchanged (Table 2.5). There is still extensive interlocking of directorships among corporations and family-controlled businesses. In addition, the TTSE is still confronted by problems relating to low market liquidity, market transparency and inadequate market surveillance.

The primary equity market has remained relatively inactive as companies have tended to use debt rather than equity financing. In fact, since the commencement of the TTSE in 1981, the total number of initial public offerings amounted to nine (9), while offers for sale totalled 14. Total capital raised from these issues amounted to approximately TT$732.8 million.

The primary equity market is further affected by the fact that companies prefer to raise capital from existing shareholders since majority owners of public companies are particularly concerned with preventing the dilution of shareholdings and loss of control. Indeed, since 1981, there have been only 14 rights issues with a total value of approximately TT$2 billion.

Table 2.5: Selected Indicators of Stock Market Activity, 1994-2003

End of Period	No. of Listed Companies	No. of Trans-actions	No. of Shares Traded (Million)	Market Value of Shares Traded (TT$ Million)	Average Daily No. of Shares Traded	Market Capitalization (TT$Million)	Composite Index	Market Capitalization to GDP (%)
1994	27	4,223	67.6	300.8	44,901	3,873.9	88.6	13
1995	27	6,186	131.6	812.4	877,679	6,750.7	150.2	21
1996	27	5,667	121.3	645.9	798,341	8,852.1	167.1	26
1997	25	7,679	100.7	846.1	671,640	19,636.9	352.3	54
1998	26	7,369	102.7	1,113.9	680,693	24,984.0	436.3	65
1999	28	3,182	92.1	735.2	493,396	27,513.5	417.5	64
2000	28	6,572	82.1	891.3	285,439	29,332.6	441.5	57
2001	30	6,609	122.2	1,044.9	836,853	31,767.6	434.2	57
2002	30	8,092	96.4	1,057.2	647,409	48,099.2	545.6	81
2003	32	16,690	409.6	2,303.2	2,786,561	67,979.6	694.1	NA

Source: Central Bank of Trinidad & Tobago

Financial Architecture of the Capital Market

Regulatory and Supervisory Systems

The SEC is the principal regulator of the capital market in Trinidad and Tobago. It regulates the conduct of all market actors, reporting issuers and self-regulatory organisations, and monitors activities in the primary and secondary markets. The SEC, however, does not possess appropriate regulatory powers under the Securities and Industry Act. The SEC has regulatory responsibility for the bond market while the Central Bank of Trinidad and Tobago and the SEC provide joint supervision of mutual funds.

Major Weaknesses in the Capital Market

Market Confidence

Low market confidence is a major problem that is limiting the ability of the capital market to mobilize and allocate funds in an efficient manner. Investors do not have access to an abundance of quality information to make investment decisions. This low confidence stems from the lack of transparency in dealings, weaknesses in mechanisms for takeover bids and inefficiencies in the pricing of securities.

Information Architecture

The information architecture of the capital market is under-developed. The disclosure, reporting and dissemination of information are extremely inadequate for investors to make appropriate and timely investment decisions. Some of the gaps relate to:

- The absence of appropriate structured disclosure standards for continuous reporting by public companies.
- Inadequate reporting and dissemination of post-trade transactions from respective capital markets.
- The absence of commercial vendors of information that could assist in the production and dissemination of information.
- Inadequate coverage and reporting of announcements of public companies and daily trading activities from major capital markets.

Credit Rating Agencies

In Trinidad and Tobago, there are no credit rating agencies and market players (borrowers as well as investors) do not generally seek the services of international credit rating agencies. Issuers of bonds in Trinidad and Tobago are not required to have compulsory credit ratings or capital adequacy requirements since there is no minimum credit rating requirement for the issuance of bonds.

Stock Market Liquidity

Liquidity in the stock market in Trinidad and Tobago is generally quite low because of the following factors:

- The inability of the TTSE to attract new listings due, in part, to:

  (i) the reluctance of family-owned businesses to disclose information
  (ii) low level of equity financing
  (iii) lack of confidence in the TTSE

- The high concentration of stockholdings in the hands of institutional investors.

- The inefficient clearance and settlement systems, which have contributed to the high "round tripping," roughly a minimum of 6 weeks to a maximum of 12 weeks, for the listing of a stock on the TTSE.

- The off-the-floor trading in listed securities of the TTSE, which has resulted in the fragmentation of the order flow of the market.

- The absence of an enforceable take-over code, which allows companies to buy a large number of shares in companies without making a formal take-over bid.

Pricing Methods for Bonds

A fundamental problem inhibiting the growth and development of the bond market in Trinidad and Tobago is the absence of appropriate yield curves, which has limited the efficient pricing of bonds.

Challenges and Opportunities for the Capital Market

Advances in information technology, recent developments in the international financial markets and ongoing international negotiations in trade in financial services have created challenges and opportunities for the capital market in Trinidad and Tobago. These can be grouped under two broad headings: (1) competition, and (2) market integrity.

Competition

It is quite likely that there will be an increase in the competition for order flows of traders among the various regional exchanges because of the cross listing of companies. The efficiency of the microstructure of these markets, which is the main driver of the costs of trading and equity financing, will be the decisive factor in determining the outcomes of the competition for the order flows of traders and listing of stocks. The full implementation of the automated trading process and the central securities depository is critical if the TTSE is to remain competitive in the regional marketplace.

Initial steps are being undertaken to introduce electronic trading on the TTSE. It is expected that electronic trading will alleviate some of the anomalies currently existing on the TTSE. Electronic trading will also instill more confidence in the stock market by improving the transparency and disclosure of transactions. The trading mechanism will now be more modernized and in line with that of highly developed and established exchanges worldwide. Electronic trading is carded to begin in May 2004 as the software has been acquired and staff members of the TTSE and the SEC have already been trained. Before this formal introduction, however, there will be a series of simulations that will take place in April 2004.

Local and regional exchanges will more than likely be forced to compete with more efficient stock markets in developed financial centres such as New York and London, since these markets provide investors with opportunities for diversification. Current ongoing multilateral (WTO) and regional (FTAA) negotiations on trade in financial services will result in regional capital market service providers (exchanges, clearance and settlement agencies, brokerage houses and other professional intermediaries) facing increased competition along the entire value chain of activities that constitutes the capital market.

Market Integrity

As the local capital markets become more integrated regionally and internationally, the issue of market integrity will become increasingly important for mobilising domestic and foreign savings. Corporate governance will be a critical factor in engendering market integrity and confidence.

2.2.3 The Insurance Sector

Structure of the Insurance Sector

At the end of 2002, there were 47 companies registered to carry out insurance business in Trinidad and Tobago. Of these, 44 were local companies and 3 were Caribbean companies. Local companies were responsible for 93 per cent of new business written (Table 2.6). These institutions were registered to carry out two broad categories of insurance: long-term and general insurance. In 2002, long-term gross premiums made up 67 per cent of total gross premiums. Currently, no company is writing reinsurance business.

Table 2.6: Structure of the Insurance Industry, 1993 – 2002

	1993	1994	1995	1996	1997	1998	1999	2000	2001	2002
No. of Companies	57	57	58	61	61	55	49	47	47	47
of which local:	49	49	50	53	54	50	44	44	44	44
Type of Business										
(% of premiums)										
Long-term	46	50	52	64	60.7	56	63	62	69	67
Motor	13	15	12	14	11.8	16	14	14	12	11
Property	21	22	24	10	16	17	13	13	11	13
Distribution of										
new business written										
Local	86.9	88	90	89	91	90	90	88	92	93
Other	13.1	12	10	11	9	10	10	12.	8	7

Source: Office of the Supervisor of Insurance.

Performance of the Insurance Sector

Gross premiums written by the insurance industry generally trended upward during the period 1993 to 2000 (Table 2.7). At the end of 2000, gross premiums were valued at US$391.3 million, representing an increase of 81 per cent from the US$216.2 million written in 1993. In terms of penetration of the national economy (measured by premiums as a percentage of GDP), the penetration ratio rose to 4.8 per cent in 2000 from 4.3 per cent in 1994. The gains made by the industry can also be viewed from the perspective of insurance density, which is measured by total premiums per capita. This figure increased to US$303.4 in 2000 from US$172 in 1993.

Table 2.7: Performance of the Insurance Industry, 1993 - 2000

	1993	1994	1995	1996	1997	1998	1999	2000
Gross Premiums (US$Mn) of which:	216.2	231.8	290.0	260.0	334.2	302.0	350.9	391.3
Long-term	107.1	107.8	144.6	140.5	196.8	168.5	222.8	241.6
Motor	32.7	31.5	34.1	36.1	38.4	47.9	49.3	54.3
Property	47.8	50.4	65.7	51.3	51.7	49.7	45.0	50.1
Other	28.6	40.0	33.0	34.6	37.4	36.0	33.8	45.3
Penetration ratio (Gross Premiums as a percentage of GDP)	n.a.	4.3	5.4	4.5	5.7	5.0	5.4	4.8
Density (Premiums per capita)	172.0	184.4	230.0	205.8	262.1	236.9	273.4	303.4

Source: Office of the Supervisor of Insurance.

Financial Architecture of the Insurance Sector

Regulatory and Supervisory Systems

Local legislation in the insurance industry has not kept pace with changes in supervisory standards, innovations in the provision of insurance services and technological developments that have occurred since the last amendments to the Insurance Act, which were embodied in a new Insurance Act in 1980. In particular, regulatory and supervisory systems are inadequate to address the current blurring of lines that has occurred in the insurance industry with respect to the provision of services. These developments have radically transformed the local insurance industry, affecting the variety and complexity of insurance products and modes of distribution.

The regulatory and supervisory reform process, including revision of the provisions of the Insurance Act currently being undertaken within the sector, addresses many of these weaknesses. In particular, the transfer of responsibility for insurance supervision from the Office of the Supervisor of Insurance in the Ministry of Finance to the Central Bank represents the initial step in this reform process. This will also significantly enhance the technical and human resource capabilities of the regulatory authority and integrate banking and insurance supervision**.** In addition, subsequent comprehensive legislative proposals to improve the regulatory framework will go further in ensuring a sound and stable insurance sector, which will be supported by a more proactive approach to regulation. Together, these enhancements address important regulatory issues with respect to:

- *Consumer Protection* – Consumer protection will be strengthened through a focus on risk-based capital adequacy requirements and increased corporate governance.

- *Moral Hazard* – This will be mitigated by the application of enhanced prudential requirements.

- *Market Integrity* – This will be supported through greater transparency (information disclosure), fairness (access to information), and measures to prevent market manipulation.

- *Systemic Risk* - Contagion effects will be reduced, as the integrated approach to oversight will provide supervisors with a comprehensive assessment of overall sector risk.

- *Regulatory Arbitrage* – Enhanced supervision within a more comprehensive legislative framework will reduce opportunities for regulatory arbitrage.

<u>Major Weaknesses in the Insurance Sector</u>

The main difficulties facing the insurance sector in Trinidad and Tobago and the limitations these place on the growth and development of the industry are linked to the inadequacy of the overarching legislation and deficiencies of the administrative regulatory apparatus. While institutional changes and legislative reforms have been implemented within the last decade for other sectors of the financial system, the insurance sector has not benefited from similar improvements which are necessary to ensure growth, development, profitability and innovation within the sector. Some of the more severe flaws in the regulatory and supervisory systems include:

Human Resource Constraints

Technical and human resource constraints have limited the ability of the Office of the Supervisor of Insurance to conduct effective oversight of insurance companies in Trinidad and Tobago. The four-year lag between the current year and the last published report of the Supervisor of Insurance demonstrates the burden placed on the limited resources of the Supervisor's office to ensure compliance by active companies.

Power of the Supervisor of Insurance

As early as the 1980s, it was recognized that effective supervision required an increase in the powers of the Supervisor. On many occasions, remedial powers of intervention into the affairs of non-compliant companies by the Supervisor have been challenged in the courts.

On-site Inspection

A related weakness of the regulatory system is the lack of on-site inspection of the operations of companies. Furthermore, examiners have limited access to financial accounts, related documents and information systems.

The Traditional Approach to Supervision

The Supervisory Authority still places too much emphasis on traditional approaches to financial supervision. Proactive and risk-based approaches, which require Supervisors to monitor risk within the sector and ensure that the level of risk is manageable so as to protect policyholder's interests, are not implemented. Instead, the existing approach to supervision in Trinidad and Tobago is reactive, focusing on the identification of problems associated with the contravention of law and the reconciliation of company data. This approach is very time-consuming and places a significant burden on the Supervisor.

Reporting Standards

The proper assessment of company performance by the Supervisor and the wider public has been stymied by the existence of poor reporting standards and/or the absence of uniformly applied financial reporting standards. Effective oversight requires a reporting framework that ensures timely reporting, more detailed reporting standards and public disclosure of financial statements by all companies whether publicly listed or privately owned.

There are no IFRS covering the reporting of life insurance liabilities. Such standards are unlikely to become available until 2005 and may pose some challenges for developing economies. In the interim, companies calculate their liabilities using UK, US or Canadian actuarial and accounting methods, which provide no consistency or comparability for regulatory and financial analysis purposes.

Taxation and Regulatory Treatment

There are significant differences in the tax and regulatory treatment of different financial services providers and their products. The blurring of traditional business lines is leading insurance companies and banks to issue products which appear similar but which have significantly different regulatory structures. It is expected that if the basic product of both institutions has similar risk characteristics, issues such as consumer protection should in principle be accorded similar treatment.

The imposition of the 5 percent tax on bank savings products, while no tax is imposed on surrender values of insurance policies, has led to a significant market in recent years in "insurance" products that are effectively fixed deposits with little or no real insurance element. The removal of the tax on interest savings will remove this tax anomaly. However, other anomalies remain. For example, commercial banks must post reserve requirements on their customer deposits with the Central Bank as well as pay Deposit Insurance premiums. By comparison, insurance companies are not required to make such payments. They are, however, subject to the investment restrictions of the Insurance Act. This different treatment could lead to regulatory arbitrage and must be addressed at the regulatory level.

Differential tax treatment also applies to approved deferred annuities issued by life insurance and trust companies. Currently, a life insurance company or a trust company can sell deferred annuities approved by the Board of Inland Revenue under Section 28 of the Income Tax Ordinance. The sale of a deferred annuity by a trust company is not subject to any form of direct regulation or prudential oversight; however, if sold by a life insurance company, this transaction will be subjected to the requirements of the Insurance Act.

Most financial institutions, including general insurance companies, are taxed on a corporation tax basis. Life insurance companies, however, are treated quite differently; they are taxed at 15% of their investment income, less investment-related expenses. This treatment extends to income arising from products such as pension plans and approved deferred annuities. There is a further tax equal to the difference between the corporation tax rate and the 15% on any amounts transferred from the policyholders' to shareholders' funds. Some companies are able to capitalise on this by building up surpluses within their policyholders' funds, thereby deferring the additional tax payment. This underscores the need for standards on what value should be placed on insurance liabilities for accounting and/or tax purposes.

Capital Requirement

Low barriers to entry, particularly with respect to the very low capital required to conduct business - TT$3.0 million for long term business and $1.0 million for other classes - have led to an over-saturation of the industry with less efficient service providers. Consequently, many of the companies writing general business are unable to earn an underwriting profit and this threatens their ability to pay claims. Further, non-compliance with minimum solvency requirements and weak supervision have led to a perpetuation of the problem by making it easy for these insurers to remain in business.

Claims Fulfilment Practices

Claims practices and service by some industry players have created a poor public image of local providers, giving rise to reputational risk. Given the expected increase in competition from foreign providers, it is important that a suitable standard of claims settlement be introduced in order to limit consumer flight to perceived higher-quality foreign providers.

<u>Challenges and Opportunities for the Insurance Sector</u>

Illegal Cross-Border Competition

The increasing incidence of "suitcase traders" presents unfair competition to local insurers, since these traders, in addition to not being legally registered, do not have to meet local capital requirements or incur any overhead costs related to running and operating a local office.

The advent of the Internet has exacerbated this problem. Online services provided by unregistered foreign suppliers present competition for the industry that it is not well suited to meet.

International Terrorist Attacks

The terrorist attacks that occurred on September 11, 2001 in the United States have forced many insurers and re-insurers globally to reassess the implications of terrorism on the insurance industry. The immediate impact of the terrorist attacks has been an increase in insurance premiums in response to higher reinsurance rates. The deeper implication of higher premiums is the potential for a greater disparity, in terms of competitiveness, to develop between local and foreign insurance providers. While local providers will be obligated to accept higher international reinsurance rates, foreign providers may be able to capitalize on greater economies of scale and vertical linkages with their international parent companies and thus minimize the size of rate increases and enhance their competitiveness.

Trade Liberalization

Trade Liberalization can provide opportunities for the local insurance sector. Consumers are likely to benefit from a wider choice of products and lower costs of coverage afforded by the more sophisticated foreign suppliers who can provide more complex insurance products at affordable premiums. Furthermore, the increased competition in the local market may result in an overall downward trend in premiums as providers manoeuvre for market share.

The CARICOM Single Market will also produce new opportunities for local insurers to expand operations across the CARICOM region. Given the relatively greater sophistication of local providers in Trinidad and Tobago compared to their CARICOM counterparts, local providers have the potential to become dominant suppliers of insurance services to the region.

While trade liberalization has benefits for the local industry, it also presents threats, which include:

- Loss of market power/share by domestic firms to trans-national interests.
- Repatriation of profits by foreign entrants to more established financial markets.

Complexity of Group Structures

Some insurance companies are integral parts of complex corporate group structures that engage largely in non-financial activities. The interrelationships that exist within these corporate structures present a significant challenge for consolidated supervision and regulation.

The Use of Non-Traditional Distribution Channels

There are numerous options available to insurers who are seeking to expand markets through the adoption of new approaches to distributing their products. Innovations in distribution include telemarketing, direct mailing, the Internet, and strategic alliances with banks, department stores and retail traders. However, many of these channels require supporting legislation and regulation to ensure consumer protection and financial soundness. New legislation and new approaches to regulatory oversight must address and enhance this potential for growth in the market.

A Rationalized Insurance Sector

Planned revisions to the supervisory and regulatory systems, as well as the introduction of new legislation intended to strengthen the powers of the Supervisory Authority, improve the capital base of companies and promote greater financial soundness of the industry, are likely to result in a decline in the number of insurance companies as less efficient companies find it difficult to meet the new prudential standards and may be absorbed by more efficient ones. The existence of fewer but more efficient companies should provide a boost to future growth and development of the sector.

2.2.4 The Pension Industry

<u>Structure of the Pension Industry</u>

The pension industry in Trinidad and Tobago comprises a mixture of private and public pension fund arrangements of varying structures, viz. voluntary or mandatory, defined benefit or contribution, funded or non-funded and publicly administered or privately managed. The publicly administered pension system comprises three major areas: the Old Age Pension System (OAP), the National Insurance Scheme (NIS) and the Public Service pension arrangements. The privately managed tax approved schemes consist essentially of two categories: private occupational pension plans sold by insurance companies and individual annuity-type products sold by insurance companies, banks and trust companies. There are also non-tax approved retirement savings arrangements, such as mutual fund based savings plans.

The OAP is a means-tested non-contributory pension scheme that provides monthly payments for persons sixty-five years and over, provided that the person has been resident in Trinidad and Tobago for at least twenty (20) years prior to the date of claim and is not in receipt of income greater than TT$12,000.00 per annum from other sources. It is not funded with payments being made from general government revenues.

Contributions to the NIS are mandatory for all employed persons and unpaid apprentices. It was established to provide a minimum level of benefit payments to employed persons, other than the self-employed, in the event of loss of income due to retirement, injury and disability sustained on the job, sickness and maternity leave. It also pays a survivors' benefit to the dependents of the insured in the case of death. Contributions are calculated weekly, based on a twelve-class income scale and are shared in the ratio of 1:2 between employees and employers. Likewise, benefit payments are also based on the twelve earnings classes.

The various Public Service pension arrangements, for the most part, are non-contributory and provide pensions upon retirement to employees of the Civil Service. However, members of the Police and Fire Services, the Defence Force and Members of Parliament contribute to their pensions. Benefit payments are borne by the government and are paid out of general revenue.

Private occupational pension plans are contributory and normally funded jointly by employer and employee. They are either of the defined contribution type, which does not cap the retirement benefit, or the defined benefit type, for which the retirement benefit is calculated based on the length of service and final-salary formula. The funds in these plans are privately managed either independently by an appointed investment manager or institution (self-administered), or managed as a pool of funds under Deposit Administration Contracts (DACs) with insurance companies or segregated funds newly offered by a mutual fund company.

Annuities are individually negotiated contracts between individuals and financial institutions such as insurance companies or trust companies. The terms and conditions that apply to premium payments are flexible - from being defined in terms of rate and frequency to being totally at the discretion of the individual. The accumulated premiums plus the income earned on their investment over the agreed period of the annuity contract are then, at maturity, used to effectively purchase a fixed and regular pension payment over a future period.

A related group of products are tax-approved group investment linked deferred annuities owned by an employer on behalf of the employees. While employees cannot contribute to these arrangements, the contributions made by the employer can only be used for the benefit of the designated employees. Like occupational pension plans, employer owned group deferred annuities arises from the employment contract or collective bargaining process. Life insurance and trust companies issue these contracts or trusts in much the same way as individual deferred annuities.

Performance of the Pension Industry

At the end of 2000, there were two hundred and eight (208) registered occupational pension plans according to the Report of the Supervisor of Insurance for that year (Table 2.8).

Table 2.8: Number of Self-Administered and Insured Pension Plans, Selected Years

Year	Insured	Self-administered	Total
1980	102	42	144
1990	145	66	211
1992	144	73	217
1995	151	81	232
1998	130	82	212
1999	153	87	240
2000	120	88	208

Source: Office of the Supervisor of Insurance

Of these, eighty-eight (88) were self-administered and one hundred and twenty (120) were insured, i.e. invested in DACs with Life Insurance Companies. It should be noted, though, that the former figure is understated, as financial accounts for several large, self-administered pension plans were listed as "not received". Since the beginning of the 1990s, the number of self-administered plans has been increasing, while the number of insured plans has been decreasing. Total assets of private occupational pension funds have been estimated to be closer to TT$20 billion at the end of 2003, with self-administered plans accounting for over 80% of these assets (Table 2.9).

Table 2.9: Total Funds Under Management, Selected Years

($000)

Year	Self-Administered	Insured	Total
1980	538,852	95,368	634,220
1990	2,189,490	539,019	2,728,509
1992	3,661,967	859,961	4,521,928
1995	3,554,429	919,205	4,473,634
1998	5,671,678	1,624,087	7,295,765
1999	7,205,970	1,513,330	8,719,300
2000	8,408,060	1,451,787	9,859,847
2001	10,615,282	1,306,797	11,922,079

Source: Office of the Supervisor of Insurance

Approximately 85% of the investment portfolios of self-administered pension plans is invested locally in government-issued debt, listed equities, corporate bonds and debentures, and other money-market instruments such as certificates of deposit. The first three categories of investment each proportionately account for approximately 25% of total investments. Over the period 1975-1995, the average overall return on investment earned by self-administered and insured funds was 8.2 per cent per annum.

Performance of the Public Pension System

Contributions to the National Insurance Scheme (NIS) amounted to TT$267.2 million in 2000, while total assets stood at TT$7.2 billion. The investment portfolio of the NIS was highly skewed towards government securities and other bonds, which comprise 53% of its investment portfolio. Certificates of deposit accounted for 20% of the investment portfolio, with mortgages accounting for 4.4%, equities 18.4% and debentures 3.88%. The net yield on the investment portfolio amounted to about 11% in 1997 with net investment income rising to TT$593.7 million, up from TT$138.5 million in 1991.

Expenditure on the Old Age Pension scheme, which covers approximately 78% of the population that is 65 years and over, rose from TT$267.5 million in 1997 to approximately TT$795.4 million by 2003. Public service pensions and gratuities amounted to TT$892.3 million in 2003 or 5.9% of government's current expenditure for that year. In total, payments of both public service and old age pensions were TT$1,687.7 million or just over 11% of government's current expenditure in 2003. The cash outflows from this liability of the State are projected to increase substantially over the next 10 to 20 years, as the bulk of the current civil service workforce retires.

Financial Architecture of the Pension Industry

The operation of the pension system in Trinidad and Tobago is governed by various pieces of legislation. The OAP and Widows and Orphans Pension systems are governed separately by the Old Age Pension Act, Chap. 32:02 and the Widows and Orphans Pension Act, Chap. 23:54, while the NIS is governed by the National Insurance Act of 1980 and its various amendments. Civil Service pensions are governed by the Pensions Act, Chap. 23:52. Certain provisions or sections in the Pensions Act, Chap. 23:52 are applicable to the Pensions Extension Act, Chap. 23:53 for employees of Statutory Authorities, the Teachers' Pension Act, Chap. 39:02 and the Assisted Secondary Schools Teachers' Act, Chap. 39:03; and the Municipal Corporation (Pensions) Act, Chap. 25:05 for employees of the regional corporations. Pension schemes for the protective services are governed by the Defence Force Act, Chap. 14:01 for the Defence Force: the Police Service Act: Chap. 15:01 for the Police Service; the Prison Service Act, Chap. 13:02 for the Prison Service; and the Fire Service Act, Chap. 35:50 for the Fire Service.

Occupational pension plans and deferred annuity products issued by life insurance companies are subject to regulation by the Supervisor of Insurance. For tax approval, occupational pension plans must be established under formal trust documents approved by the BIR under section 28 of the Income Tax Ordinance. This includes several provisions such as the requirement for member representation as a Trustee or Management Committee member. The BIR will only approve documents that meet restrictions imposed by the law or BIR practice as guided by draft pension regulations. This includes limits on the amount and nature of benefits. The plan documents must also be registered with the Supervisor of Insurance under the Insurance Act to take legal effect. The Insurance Act deals with such governance issues as filing audited financial statements and actuarial valuations with the Supervisor of Insurance. It also gives the Supervisor of Insurance the power to take action in a court of law as if the Supervisor of Insurance was a beneficiary to the pension plan. The Second Schedule to the Insurance Act governs the investment of pension fund assets.

Individual investment linked tax-approved deferred annuities are also approved under section 28 of the Income Tax Ordinance. Contracts sold by trust companies are not subject to the Insurance Act and are only subject to the restrictions imposed by the tax legislation. In particular, they are not regulated by the Supervisor of Insurance. For example, they are not subject to investment limits and there are no market conduct requirements. Employer-owned investment linked group tax-approved deferred annuities are approved under section 134(6) of the Income Tax Ordinance. This imposes different restrictions to individual deferred annuities. The regulatory and taxation differences between contracts issued by life insurance companies and trust companies are similar to those for individual contracts.

Major Weaknesses in the Pension Industry

Investment Opportunities

The range of investment opportunities for pension funds registered in Trinidad and Tobago is relatively limited in relation to the quantum of assets available for investment. The Insurance Act of 1980 specifies that a minimum of 80% of the assets of pension funds must be invested in Trinidad and Tobago. Investments are further restricted in large measure to equities, real estate, certificates of deposit and mortgages and are subject to stipulated limits imposed by the Insurance Act. The limit on equity investment is set at a maximum of 50% of a fund's assets and real estate up to 20%, with no single mortgage exceeding 10% of the fund value.

These quantitative restrictions have led to a significant concentration of pension fund investment in Trinidad and Tobago, and have limited the ability of pension funds to reduce local market risks through international diversification.

Legislation for Pension Funds

Pension arrangements in Trinidad and Tobago are regulated by various pieces of legislation that apply to different pension arrangements. The Insurance Act of 1980 sets out the provisions for the registration of occupational pension plans and deals essentially with the form, structure, authorized investments and operational controls. It also regulates life insurance companies that issue deferred annuities and provide investment management and administration services to many occupational pension plans. The Income Tax Ordinance and BIR practice, in particular the draft pensions regulations, impose limits on the contributions, benefits and structures of occupational pension plans and deferred annuities. The Trustee Act regulates the activities of all trustees, including individuals, corporate trustees and de-facto trustees such as Management Committee members. The Financial Institutions Act (FIA) regulates the establishment and operations of licensed Trust companies that act as trustees and investment managers for occupational pension plans and sell deferred annuities. The OAP and NIS are regulated by additional pieces of legislation. Fragmentation of the legislative and administrative arrangements has made it very difficult to manage and supervise, in a uniform manner, both public and private pension arrangements.

Disclosure of Information on the Financial Performance of Pension Plans

One of the major complaints made against private occupational pension funds is the lack of timely submission of audited financial statements and actuarial valuation reports to the Supervisor of Insurance. Also, the annual reports produced by the Supervisor's Office lag in terms of timely disclosure on average by about two years. This lack of current information makes it very difficult for the Supervisor of Insurance to discern pending crises or regulate the industry in a proactive manner. It also makes it difficult for the general public to assess the performance of occupational pension plans.

Ownership of Surpluses

There has been much conflict as to whether the surplus accrued in a pension plan belongs to the sponsor of the plan or whether it should be utilized for the benefit of the plan's members, given that both parties make capital contributions. Ownership becomes even more contentious in the case of acquisition of a going concern, where the new owners lay claim to pension surpluses as the sponsoring employer, or where the company is being wound up. Although the Trust Deed and Rules of pension plans, more often than not, detail how the application of surpluses is to be dealt with, in reality it remains an issue open to debate and challenge, as there are no laws in Trinidad and Tobago relating to ownership of these surpluses.

Appropriate Indexation

The lack of appropriate indexation has caused substantial deterioration in the contribution base of the NIS. The current legislation does not institute increases in benefits and contributions based on movements in the Retail Price Index (RPI), especially the medical care component, or increases in wages. Although increases in benefits and payments can be recommended on the basis of an actuarial review, mandated by law to be performed every three years, the speed of implementation of these recommendations greatly lags the increases in general prices. The lack of adjustment for automatic changes in wages or inflation will eventually erode the contribution base of the NIS, erode the value of the average pension benefit that accrues to pensioners, and undermine the financial integrity of the NIS.

Integration of Benefits in the Public Pension System

Until recently, when a minimum pension payment of $1000 per month was introduced by the NIS, payment of monthly pensions under this contributory programme was significantly less than the monthly pension payment under the non-contributory OAP. This anomaly arose out of the absence of indexation of NIS benefits and the lack of harmonization and integration between the two programmes.

Portability Provisions in Public Service Pensions

Pension benefits under the Civil Service Pension and the Teachers Pension Plans are un-funded and are paid from Government's general revenues, while accrued liabilities on behalf of Government are indeterminate at this time. A critical constraint in these pension plans is the absence of any provisions dealing with the issue of portability of individuals' pension benefits, which has served to some extent to constrain the movement of employees out of and into the Public Service.

<u>Challenges and Opportunities for the Pension Industry</u>

Regulatory Reform

The consolidated supervisory project now ongoing at the Central Bank of Trinidad and Tobago is a comprehensive attempt to overhaul the banking and insurance sectors, and provides an avenue through which the regulatory and supervisory systems for the administration of private pension schemes can be achieved.

Public versus Private Involvement in the Pension Industry

Within recent times there has been some significant debate about the role that government should play in the management of pension funds. This debate has surfaced in response to the issue of whether the pension system can be made more financially viable without losing its core social insurance objectives. There is a strong belief in many quarters of the private sector that the government should not get too deeply involved in the management of pension funds and should limit its involvement to the design of appropriate regulatory standards.

Reform of the Pension Industry in Trinidad and Tobago

In recognition of the need to modernize the pension industry in Trinidad and Tobago, Government has established a Pension Reform Committee with the mandate to review the current pension regime, and develop a detailed plan for reform of the pension system in Trinidad and Tobago.

The Committee will be examining and addressing a number of issues including consolidation and modernization of the existing pension legislation governing the industry, harmonization and integration of the OAP and NIS, pension portability, fit and proper criteria for fund managers, indexation of pension benefits and contributions in the public sector, minimum guaranteed pension levels, minimum replacement ratios, pension accrual rates in the Public Service, quantification of Government's accrued pension liability, and the introduction of funded occupational pension plans in the public service.

2.2.5 The Mutual Funds Industry

<u>Structure of the Mutual Funds Industry</u>

At the end of 2001, there were thirteen mutual funds sponsored by five local institutions: more specifically, four subsidiaries of commercial banks and one special purpose institution, the Trinidad & Tobago Unit Trust Corporation. Altogether, these institutions managed TT$10.0 billion in funds through the following:

- Two (2) local income and growth funds;
- Four (4) local money market funds;
- Two (2) US dollar-denominated, Cayman Islands domiciled global income and growth funds;
- Two (2) US dollar-denominated US income and growth funds;
- Two (2) US dollar-denominated money market funds; and
- One (1) US dollar-denominated Caribbean equity fund.

The UTC accounted for 47 per cent of the market and the trust company subsidiaries of commercial banks the other 53 per cent. In terms of the types of funds, local money market funds accounted for approximately 76.1 per cent of the funds under management; US dollar money market mutual funds accounted for 8.9 per cent; local income and growth funds 14.8 per cent; and US dollar-denominated income and growth funds less than 1 per cent.

Performance of the Mutual Funds Industry

Total funds under management in the mutual funds industry showed remarkable growth over the period 1994 to 2001. In 2001, funds under management stood at TT$10,005 million compared to TT$841.3 million in 1994, representing an average annual growth rate of 155.6 per cent over the period. The entrance of new and different types of mutual funds and the improving economy facilitated this strong growth.

The performance of the growth and income funds mirrors the changes in value of the underlying portfolio of equities, while the interest rate was the critical factor impacting on the performance of the money market funds. Net sales of money market funds increased every year during the period 1994 to 2001, rising from TT$109.2 million in 1994 to TT$1,593 million in 2001, at an annual average growth rate of 169.8 per cent. Net sales of the income and growth funds were much more uneven, increasing from TT$66.1 million to TT$498.9 million in 1998 and then declining to TT$179 million in 1999, as the equity market softened.

Financial Architecture of the Mutual Funds Industry

Regulatory System

Currently, there is no clearly defined regulatory structure for mutual funds. Although the Unit Trust Corporation of Trinidad and Tobago Act, 1981 (UTC Act) sets out a number of rules to govern the operations of the UTC, it contains no guidelines on prudential standards or supervisory procedures, nor does it define an appropriate regulator. Further, amendments to the Act have concentrated only on the operational scope of the UTC and not on the industry. The introduction of the SEC in 1997 was meant to fill this regulatory gap; however, this institution has still not developed rules for the functioning of the market nor has it put in place a system for monitoring mutual funds.

The Central Bank has issued guidelines, not enforceable in law, on mutual funds established by institutions licensed under the Financial Institutions Act. However, the proposed Mutual Funds legislation will fall under the ambit of the SEC. This could create difficulties in terms of regulatory jurisdiction as mutual funds could then become subjected to two regulators - the SEC and the CBTT - with the former regulating the capital market business (under which mutual funds fall) and the latter the banking business.

Legislation

The UTC operates under the legislative umbrella of the UTC Act. This Act sets investment guidelines, restrictions and disclosure requirements, and limits the management fee that the UTC can charge. It was amended in 1997 to allow the UTC to carry out several of the classes of business of a financial nature set out in the First Schedule of the FIA, except banking. Although the Act sets disclosure requirements and investment restrictions, there is no regulator actively monitoring the operations of the

UTC to ensure compliance with the provisions of the Act. Additionally, the question arises as to whether or not the UTC should fall under the proposed Mutual Funds Legislation.

Establishing the framework for the effective regulation of the mutual funds industry requires a separate piece of legislation mapping out licensing arrangements, corporate governance standards, disclosure requirements, capital requirements or guarantee funds, and investment guidelines. Additionally, the legislation should address the regulation and supervision of the mutual funds industry.

Taxation

The tax regime impacts significantly on the performance of mutual funds. The tax-preferred status of the UTC and its unit-holders before 1996 assisted in its phenomenal growth. The removal of the dividend income allowance and other tax breaks in 1996 impacted significantly on the magnitude of the returns that the UTC could provide to its shareholders. In the present situation the UTC is exempt from corporation tax, which provides the institution with an artificial advantage over its competitors.

Human Resources

The fast pace of growth of the mutual funds industry in Trinidad and Tobago could put a strain on the human resource pool of experienced fund managers. Sponsoring institutions must pay specific attention to this issue if they are to avoid the dilution of their human resource base in an increasingly challenging and competitive environment. This situation is likely to become more acute for the regulatory and supervisory system, given the remuneration differentials between the public regulatory system and the private financial institutions.

Additionally, fund managers should be encouraged to improve their in-house capacity for market surveillance, since the provision of this service by third parties can be self-serving. The capacity of fund managers to evaluate the significance and credibility of third party information, in the face of increasing market risks in the local, regional and international market place, should be expanded.

Financial Reporting Standards

Transparency and disclosure are important elements of a successful mutual funds industry. These elements have been designed to protect investors and to help provide a level of market discipline to fund managers. Information disclosure guidelines have also been developed by the CBTT and may eventually form part of new mutual funds legislation. Transparency and disclosure are, however, not going to serve their purpose if there are no standards with respect to information disclosure. The introduction of financial reporting standards should therefore form a critical part of the regulatory requirements.

Major Weaknesses in the Mutual Funds Industry

Regulatory and Supervisory Structure

The absence of a formal regulatory and supervisory structure for the mutual funds industry is an important issue that needs to be addressed. An omnibus piece of legislation to regulate the industry has not yet been put in place. This is compounded by the unclear boundaries between the jurisdiction of the CBTT and that of the SEC.

Nature of Incorporation of the UTC

The UTC is hampered by the nature of its incorporation, which restricts its flexibility in responding to developments in the market.

The Movement of Funds Offshore

The movement of funds offshore in search of increased investment returns not only contributes to a loss of tax revenue, but could also complicate the regulation and supervision of the mutual funds industry.

Challenges and Opportunities for the Mutual Funds Industry

Regional Market Penetration

The possibility of expanding into the regional market is one opportunity available to local mutual funds, since many of these markets do not have well-developed mutual funds industries. Already, some local firms have established a presence in other markets in CARICOM.

Market Entry

The entry of other non-bank financial institutions into the mutual funds industry could help to further enhance the competitive nature of the sector. However, this would require a levelling of the playing field, particularly as it relates to the preferred tax status of the UTC. The entry of new firms could also stimulate an expansion in the types of funds available.

On-Line Investment

On-line access to investments in international capital markets is likely to become increasingly important as local investors become more sophisticated. The low investment costs (fees for brokers) and access to potentially higher returns from on-line brokers present direct competition for the local mutual funds industry. The local industry will therefore need to ensure that the risk and return profiles of its various portfolios are competitive when benchmarked against global standards of performance.

2.2.6 The Credit Union Sector

<u>Structure of the Credit Union Sector</u>

The credit union sector is comprised of an estimated 143 credit unions (CUs), of which 100 actively conducted business at the end of 2003. Credit unions can be classified according to the type of "bond" under which they operate or by their asset size. At the end of December 2000, the total assets of the sector amounted to TT$2.5 billion (Table 2.10). By the end of December 2003, total assets of the sector were estimated to be in excess of TT$3.5 billion, with the eight largest credit unions accounting for 60 percent of this figure while the 20 largest accounted for 85 percent of the assets.

Table 2.10: Credit Unions by Asset Size, 2000

Asset Size	No. of Societies	Total Assets
< $25 Mn.	35	$295,018,204
$25- $50 Mn.	12	$381,717,576
$50-$100 Mn	11	$702,324,609
> $100 Mn.	6	$1,217,668,942
Total	64	$2,596,729,331

Source: Co-operative Credit Union League

Supervisory and Regulatory Systems

The credit union sector is currently supported by institutional arrangements created to provide support services and/or supervisory and regulatory control. While the Co-operative Development Division of the Ministry of Labour and Small and Medium Enterprise Development and Co-operatives is the primary regulatory body, some regulation is also undertaken by the Credit Union Supervisory Unit (CUSU), which has been established within the Ministry of Finance. Additionally, the Co-operative Credit Union League (CCULTT) is the umbrella body responsible for advocacy and the provision of training of employees of the CUs. Membership in this organization is voluntary.

The Credit Union Stabilisation Fund was established to ensure the security of members' shares and deposits, and to protect the stability of societies through preventative and curative assistance. While insurance cover and protection are provided through CUNA Caribbean, an insurance company that caters primarily to member credit unions, a new organization, the Central Financing Facility, geared to becoming the lender of last resort for the sector, was recently launched. As with the CCULTT, membership in these organizations is also voluntary; however, because of inadequate funding, these institutions have not been able to fully undertake their developmental roles.

Performance of the Credit Union Sector

Although several CUs are engaged in other activities such as foreign exchange, retail of consumer products and travel service, the majority of credit unions provide only two kinds of service: savings, either in the form of shares or deposits, and loans.

In the case of savings mobilisation, the performance of credit unions has been remarkable. Credit union savings grew from TT$32.1 million in 1973 to TT$2 billion in 2001. During the 1980s, credit union savings as a percentage of gross domestic savings reached a high of 30.4 per cent compared with 2.1 per cent during the 1970s. Credit Unions have generated substantial financial resources, which have been utilized to fund loans in areas such as housing, education and the establishment of small businesses.

Loans, which are the major assets of credit unions, comprise about 75 per cent of total assets. However, in many institutions the quality of this asset is affected by delinquency rates estimated to be as high as 20 per cent in some instances.

CUs have sought to improve their operational efficiencies through the adoption of the PEARLS system. At least 60 per cent of the members of the CCULTT have computerized their operations and have accepted the PEARLS' standards for financial management.

Financial Architecture of the Credit Union Sector

The Co-operatives Society Act, Chap 81:03, which governs the credit union sector, is outdated and does not address those issues that have become pertinent to the stability and survival of the sector. Further, provisions concerning delinquent loans, the registration of societies, financial reporting and the election of officers need to be revisited or included in this legislation.

Information Technology Infrastructure

Credit Unions have been making good progress in improving their information architecture. Most credit unions utilize computers in their operations, both for record keeping and for data and information processing. Although the more sophisticated CUs have expensive software packages to assist with the efficiency of their operations, there is still considerable reliance on paper files, especially in the administration of credit. Greater utilization of information technology will be an essential element for the future success of the sector.

Taxation

Credit unions are exempt from paying corporation taxes and this incentive has been a critical means of support for the development of the smaller credit unions.

Major Weaknesses in the Credit Union Sector

Growth in Membership and Share Capital

An important element in the success of any credit union is its ability to increase its membership and consequently its shares. The growth of shares in most CUs had been particularly flat in the 1980s when the Government introduced an incentive scheme aimed at boosting share growth. Indications are that the programme has had limited impact. The dependence on the growth of shares as a source of funding for loans is problematic and some CUs have resorted to lending from reserves in order to meet demand.

Management and Operating Systems

Traditionally, the CU sector has relied upon voluntary professional managers. However, as the institutions expanded, the need for more highly trained personnel became evident and many CUs have begun to employ skilled managers with qualifications in management and supporting staff with previous experience in banking. The limitations imposed by scarce human resources have also presented a challenge to the Department for Co-operative Development, which is unable to discharge its functions effectively. The performance of the sector in the future will therefore depend to a large extent upon how fast its managerial capacity is upgraded.

Asset Quality

The levels of liquidity and delinquency within the sector have remained issues that warrant greater monitoring and action by the CUs. The lack of reliable mechanisms for assessing creditworthiness and risks as well as the absence of a strong supervisory authority has contributed greatly to this problem.

Record Keeping and Data Management and Reporting Standards

The approach to record keeping and, by extension, data management has been influenced by the informal nature of these organizations. This has made the process of data collection on the sector very difficult.

Credit Unions are not obligated to provide audited financial statements in conformity with the IFRS. This has also contributed to the inadequate record keeping and data collection and has placed the institutions in this sector at a disadvantage in the eyes of the public, as they are perceived to be less stable than other sectors within the financial system.

Challenges and Opportunities for the Credit Union Sector

Image Dilution – The sector is perceived as being less formal and more lax in its general operations. This image can affect the sector's ability to attract middle and higher income savers, as well as qualified personnel, which is critical to the survival of the sector.

Falling Commercial Bank Interest Rates – The continuing strong liquidity in the financial system and the general reduction in interest rates could exert a deleterious effect on the operations of credit unions.

Narrow Range of Services – At present, most credit unions generally offer a narrow range of financial services. Adherence to this modus operandi will deny these institutions opportunities for enhancing their competitiveness, which a broader range of services offers. Other services that have been introduced on a limited scale include ABM services, debit and credit cards and facilities for payment of utility bills.

High Operating Costs – Most credit unions appear to be high-cost operations. The PEARLS standards of performance indicators recommend expenditure to income ratios of between 25% and 40%. The average for most CUs is between 50% and 60%.

Non-core Activities – Many credit unions engage in non-core activities that are generally unprofitable. In most cases, these activities are subsidized by income derived from lending activities, thereby compromising the profitability and effectiveness of the credit union movement.

The Future Role of the Credit Union – The credit union sector remains very relevant despite the advances that have occurred in more established institutions in the financial sector. A large percentage of the population remains below the poverty line and there may be a need to nurture the development of the smaller CUs to meet the needs of the disadvantaged and under-privileged individuals in the society. The credit unions must ensure that they continue to service this section of the population even while they expand and upgrade the quality of their financial services.

2.2.7 The Venture Capital Industry

Structure of the Venture Capital Industry

The venture capital industry in Trinidad and Tobago remains at an embryonic stage. The Venture Capital Act of 1994 establishes an institutional framework for the administration of equity financing of the Small and Medium Enterprise (SME) sector, namely, the Venture Capital Incentive Programme (VCIP). The Administrator of the VCIP accepts and processes applications made by Venture Capital Companies (VCCs) for registration under the Act; approves equity capital investments in Qualifying Investee Companies (QICs); issues tax credit certificates to investors in a VCC; and conducts annual audits of the VCC financial statements and their register of shareholders. Each

Venture Capital Company must file annual reports with the Administrator in compliance with the regulations.

A potential QIC can benefit from funding under the VCIP, provided it is a CARICOM registered company under the CARICOM Enterprises Act, employs less than 75 persons and has a paid up capital of less than TT$3 million. Venture Capital Companies registered with the VCIP must meet the following conditions:

- They must have an initial capital of at least TT$50,000.00.
- They must have an authorised share capital ranging from TT$5 million to $20 million, which must be a single class of shares carrying no special voting rights or restrictions.
- They must be restricted in their Articles of Incorporation or Continuance to assisting in business development by making only eligible investments, as detailed in the Act, and by providing business and managerial expertise to Qualifying Investee Companies.

The Act disallows investment in companies whose major business activities include the extraction of mineral resources, retail trade, provision of financial services and speculative land development.

The VCIP provides tax incentives to persons purchasing shares in registered VCCs. At present, investors in registered VCCs receive incentives equal to the highest marginal tax rate for individuals of 30 percent. Where the amount of the tax credit cannot be wholly set off against the tax assessed for the income year in which the purchase was made, the unclaimed balance may be carried forward and set off against tax assessed for succeeding years of income until the tax credit has been fully utilised.

The success of the venture capital industry depends on an adequate supply of funding from a wide cross-section of investors. Typical sources of funding are private individuals of high net worth, banks, pension funds, insurance companies, governments and non-financial companies. These entities generally channel funds to QICs via Venture Capital Companies. Given the characteristics of the venture capital companies' asset portfolios, investors in VCCs must be willing to incur losses in the immediate future, while they wait for successful investments to come to fruition.

Performance of the Venture Capital Industry

At present, there are three venture capital companies operating under the purview of the VCIP. These companies have a combined issued share capital of $14.6 million and provided investment capital of $3.7 million to eight qualifying investee companies between 1998 and 2002. These QICs operate in the tourism, media, marketing, entertainment and manufacturing sectors. The equity capital provided by VCCs has enabled the QICs to undertake capital expenditure and to meet working capital requirements. Since the programme began, there have been 472 requests for funding in the amount of $392 million. In addition to the three VCCs operating under the VCIP, there are two other private venture or equity funds which operate outside of the programme and which are registered as Issuers with the SEC.

Architecture of the Venture Capital Industry

Regulatory and Supervisory Systems

The Venture Capital Act of 1994, which was amended in 1997, and the Venture Capital Regulations of 1996 regulate the Venture Capital Industry.

Exit Mechanisms

The future growth of the venture capital industry depends on how well exit mechanisms work. Exit mechanisms provide investors with avenues to realise the value of their equity investments in the form of capital gains, as dividends during the period of investment are usually reinvested in the QIC until it is well established and exit contemplated. The investment exit routes that are available to VCCs are management repurchase (buy-outs by other shareholders), initial public offering (IPO), and private placement. Should a company be voluntarily wound-up prior to the 5-year minimum venture capital investment, the VCC will proportionately share in the proceeds of such liquidation of QIC assets.

Major Weaknesses in the Venture Capital Industry

Legal Framework

Legal restrictions on insurance companies, unit trust schemes and mutual funds prevent these institutional investors from providing capital to venture capital companies and therefore reduce the source of funds available to VCCs. In addition, limits placed on the size of the venture capital fund, the size of the investee companies that may access funds under the VCIP and the sectors in which VCCs may invest, restrict the supply of funds to eligible industries.

Restrictions on the type of financial instruments allowed under the Venture Capital Act prevent venture capital companies from structuring financial packages to reflect their risk preferences and meet the specific needs of the QICs. Also, regulations that prescribe rules of residency for directors of the VCCs restrict foreign participation and further limit the access of VCCs to additional sources of funding.

Supporting Infrastructure

The limited availability of human resources with the mix of financial and entrepreneurial skills and experience to develop and manage a portfolio of high-risk ventures has constrained the development of the industry. In particular, the structure of the country's educational system does not engender a culture of entrepreneurship, innovation and risk-taking.

The venture capital industry is also affected by the absence of a developed second-tier stock market, which can appropriately price investments and provide an exit route for the VCC to realise the high yields that its shareholders expect for the risk and duration of this type of investment security.

Challenges and Opportunities for the Venture Capital Industry

There are a number of factors that support the development of the local venture capital industry. First, the hands-on approach taken by venture capitalists in the industry provides opportunities for venture capitalists to share their skill in product development, finance, marketing and distribution.

Second, a well-functioning venture capital regime can enhance the allocation of resources. The success of venture capital depends largely on finding projects with very high earnings growth potential relative to the capital outlay. The search for such projects may enhance the allocation of scarce resources to deserving projects that may otherwise have been denied funding.

Third, the increased collaboration between government and the private sector can lead to the setting up of business incubators and a greater demand for venture capital to nurture dynamic businesses.

SECTION 3.0 <u>VISION FOR THE DEVELOPMENT OF THE FINANCIAL SYSTEM IN TRINIDAD AND TOBAGO</u>

3.1 <u>The Emerging Global Financial Environment: Implications for Trinidad and Tobago</u>

There is general consensus that a well-functioning financial services sector is essential for sustained economic growth and development. The existence of a wide and diversified set of sound, well-managed institutions and markets tends to reduce the possibility and magnitude of financial crises. Given the widespread incidence and high cost of financial crises in industrial, developing and transition economies, the most important challenge will be the promotion of the soundness and stability of the financial system in an era of rapid information and technological development.

Several developments in the international sphere have direct implications for the ability of Trinidad and Tobago to achieve its defined vision. These developments are occurring in the spheres of trade, finance, regulation, supervision and technology. Trade and financial liberalization are proceeding internationally along a variety of fronts. Under the General Agreement on Trade in Services (GATS), services liberalization requires countries to progressively open services trade through the four core modes of supply: cross-border supply, consumption abroad, establishing a commercial presence, or the movement of natural persons. The level of market opening that Trinidad and Tobago agrees to in the area of financial services will affect the level of competition that the local financial sector faces. In the initial round of GATS negotiations, this country made commitments only in reinsurance services.

Perhaps of more immediate impact are the efforts at trade liberalization under the CARICOM Single Market and Economy. Trinidad and Tobago, along with other CARICOM member states, must (in accordance with Protocol II of the amended Treaty of Chaguaramas) remove all restrictions on the rights of establishment, provision of services and movement of capital before 2005. Compliance with these obligations has several implications for this country. Removal of restrictions on ownership by regional players will allow for ownership of insurance companies listed on the stock exchange by CARICOM members. There will also be the potential for greater competition in the local financial industry as Caribbean service providers gain access to the local market through other modes, in addition to the establishment of a local presence. On the other hand, local banks may find it easier to expand into the CARICOM region. Similar effects on competition and supply are expected to arise from developments under the Free Trade Area of the Americas, the establishment of which is to be completed by 2005.

In the area of supervisory developments, the Basle Committee on Banking Supervision has been introducing new supervisory requirements, which represent international standards that progressive countries have been adopting. The Central Bank of Trinidad and Tobago has implemented, and continues to implement, many of these supervisory measures. In particular, assessments by local and independent bodies have found the country to be largely in compliance with the Basle Committee's Core Principles for Effective Banking Supervision. While the main areas of deficiency are legislative, amendments to address these weaknesses have already been proposed. Further, an Exit Policy to improve the transparency of licensed financial institutions that exit the industry has been developed by the Central Bank. The prominent features of the Exit Policy, which satisfies Principle 22 of the Basle Committee's Core Principles for Effective Banking Supervision, consist of supervisory procedures outlined in existing banking legislation, monitoring by the supervision department, and a rules-based as well as a discretionary ladder of intervention.

In addition to the strengthening of banking supervision, another aspect of international efforts to strengthen financial stability has focused on inter-bank arrangements. The Bank of International Settlements (BIS) has developed ten (10) Core Principles, which have become the benchmark for payment systems. The Central Bank is currently engaged in a process of payment system reform in accordance with these principles.

In 1999, the Basle Committee on Banking Supervision introduced the new Basle Capital Accord, which presents new supervisory requirements. When finally implemented in 2006, the proposed Capital Accord, which is intended to contribute to the safety and soundness of the financial system, will have considerable implications for competition within the financial services sector. The Accord may place local banks at a distinct disadvantage relative to their foreign (international) competitors by the very manner in which changes in the approach to assessing minimum capital requirements are being developed. The proposed accord may impose higher capital requirements on less sophisticated local banks, whilst the large international banks may be better able to adopt enhanced risk management practices thereby requiring lower capital. The new Accord will also make greater demands on the human resources of both domestic regulators and banks. Local banks will need to undertake significant work to get processes for gathering credit and operational risk data up to the standards required by Basle.

Despite the challenges presented by the proposed Accord, the implementation of a number of the requirements will be necessary if this country is to be recognized as an international financial centre. The banking sector in particular faces considerable legal and operational risks since it will be unable to enter into correspondent relationships internationally if it does not comply with the new Capital Accord.

In this respect, the establishment of a local credit rating agency is important since the methodology for assessing the risk, and by extension, the amount of capital that institutions are required to hold, is based in part on the assessment of a credit rating agency. The absence of a local or indigenous rating agency may present some difficulty under the new Accord as this will reduce the frequency and effectiveness with which ratings can be conducted for local financial institutions.

The September 11, 2001 terrorist attacks in the US brought to the fore, once again, the need for financial supervisors to ensure that local and international criminal activity is not assisted by weaknesses in the financial system. Trinidad and Tobago, in its vision to become a leading financial centre, will therefore have to ensure that local financial institutions comply with a number of local and international laws, including the Proceeds of Crime Act 2000, the proposed Financial Obligations Regulations, and the relevant clauses of the US Patriot Act, 2002.

In developing a vision for the financial services sector in Trinidad and Tobago, cognisance must be taken of the likely evolution of the global financial services industry. This industry is undergoing very rapid development and a significant shift is taking place away from financial intermediaries that offer specialized types of product towards financial intermediaries that provide a broad and diversified menu of specialized and hybrid services that can be combined in various ways to meet the specific needs of each individual customer. Although it is very difficult to visualize the nature of the financial institutions and products that will emerge over the course of the next two decades, one issue around which there is significant consensus is that information technology will play a significant role in defining the nature of financial institutions, products and regulations and hence the financial superstructure that emerges in the future.

The use of information communications technology, especially the Internet, is transforming the very manner in which business is conducted in the financial sector, and a number of new business models, which make extensive use of electronic commerce, are already beginning to emerge. In particular, financial service providers are now actively deploying web-based applications to provide new delivery channels through Internet-based call centres and online interfaces, which are guaranteeing faster delivery of new products and services. In the future, it is therefore quite likely that smart cards, video banking centres, web-based automated teller machines, new forms of digital money and a range of new technologies will deliver quite rapidly a wider array of financial services directly to consumers. It is estimated that by the year 2004, e-business globally will reach US$2.3 trillion while online financial transactions will amount to US$1.5 trillion by 2007.

There are now many modes of delivery for financial services - delivery by cross-border supply, delivery by establishment and delivery by consumption abroad - that provide consumers with a wider menu of options. In the future, consumers will be more prone to rely on the cross-border delivery of financial services rather than on delivery through establishment presence and consumption abroad, although these modes of delivery will most probably continue to exist.

The Internet now facilitates the cross-border supply of financial services by unlicensed foreign financial service providers and this presents a significant challenge for local authorities to regulate the activities of these providers. In addition, local service providers could face greater competition, particularly for higher-end products. Local institutions will face a considerable challenge to provide high quality and secure online services, given the cost of technology acquisition. The Basle Committee has also issued general principles for the provision of e-banking services that are based on the establishment of internal risk-management processes, which may prove burdensome for many local institutions to implement.

The cross-border mode of delivery may require the development of new legislation and regulatory standards, as well as new information systems that can extensively leverage the web-based technologies for real-time delivery. The new legislation will have to deal with mechanisms for guaranteeing the safety and security of digital transactions, the establishment of standards for the use of digital signatures, and new accounting rules for audit trails in cyberspace. One central question that will confront decision makers in the financial sector is the extent to which the capacity exists to effectively regulate this sector, for the benefit of consumers of financial services, in an environment in which there is rapid change in technology.

The cross-border mode of delivery will also spur the development of new financial instruments, particularly those of a digital nature (e.g. digital money), and will eventually impact on the manner in which monetary and financial policy is conducted. Monetary and financial policy will need to be redesigned to meet the challenges of web-based electronic transactions that allow for greater integration of financial activities among consumers in different spatial locations in the globe.

In summary, the existing global financial services architecture emphasizes a superstructure of financial service providers with clearly delineated functions that provide a range of differentiated but basically traditional products to customers. The financial services industry of the future is likely to involve a number of multifaceted and flexible institutions which provide the entire spectrum of financial services and which utilize online technology to provide rapid and efficient services to its range of customers.

The financing of business and consumer demands in the next three to four decades will therefore require an e-financial superstructure, consisting of a range of e-financial institutions and e-financial products, all managed by a combination of traditional legislation/regulation as well as e-legislation/e-regulation. The core challenge that faces Trinidad and Tobago in this emerging global landscape revolves around the (i) design of an e-financial superstructure and (ii) the management of the changeover from the traditional superstructure towards the e-financial superstructure.

3.2 Vision for the New Financial Landscape of Trinidad and Tobago

Given the rapid pace of globalisation and the changing structure of global capital, it is clear that there is need for a responsive and well-diversified financial sector that can contribute towards a more rapid diversification of the national economy. This diversification will require the development of new or innovative financing channels to meet the demands of the under-served sectors/communities such as small business broadly defined. In particular, it must also cater to small business entrants in non-traditional activities including activities such as the up-stream (service suppliers) and down-stream operations (value added processing) in energy-related activities, as well as financing mechanisms for the country's infrastructure, including telecommunications and public utilities.

The vision for the future is therefore to create a Pan-Caribbean Financial Centre that encompasses the entire group of ACS countries and is globally competitive, well diversified, responsive and market-driven**.** This Financial Centre should provide the widest possible range of financial products to cater to the needs of international and regional business, domestic and regional, small and medium- sized enterprises, the general public and the private sector. This Centre will be supported by a modern information technology architecture that can rapidly deliver a high quality and cost-effective menu of financial services options to its customers.

While it may not be possible to project accurately how Trinidad and Tobago's financial services sector will be structured in the next 20 years or so, taking into account the manner in which the forces of technology, globalisation and demographics are evolving, it is expected that the future financial landscape for Trinidad and Tobago will be characterised by the following:

- A large and highly developed Pan-Caribbean Financial Centre from which international financial business can be conducted profitably, easily and efficiently and with rules and codes of conduct that match the highest international standards.

- An open, efficient, sophisticated and competitive banking sector offering a wide range of financial services. These services will be accessed through multiple distribution channels, including electronic channels, and characterized by extremely high standards in delivery.

- Other financial institutions will become more focused with varying strategies based on their comparative strengths and market niches and will be at the vanguard of developments in the financial markets. This implies that:

    - Fewer large broad-based institutions will thrive, exploiting their privileged customer relationships to expand into new, profitable business areas, especially in asset management.

    - The successful institutions will be those that continue to leverage on world-class technology platforms and re-engineering work processes to offer complete financial solutions for varying types of consumers.

    - Employing and retaining highly skilled workers to explain and deliver complex products and services, while promoting a culture of excellence will become a defining characteristic of successful financial institutions.

- Specialist providers will emerge:

  - Some competing to provide specialized products by repackaging and selling loans such as residential mortgages and credit card receivables on the basis of lower costs or better marketing. These players will be regional or global in scale.

  - Some competing only in specific lines of the business chain, while outsourcing all other non-core functions (such as back-office processing, coding and payroll).

  - Some dominating specific customer niches, such as service suppliers and downstream operations in energy-related activities or high net worth individuals.

- New service providers will emerge with the advent of new communications systems and increasing popularity of electronic payment instruments, including the Internet. This may include software, telecommunications and other companies entering the first tier of the payments system to provide bill payment and basic lending services.

- The insurance industry will be more mature, sophisticated and highly competitive across general, life and reinsurance businesses:

  - The general insurance industry will have a reputation for innovation in customer service and product development and will be a regional leader in alternative risk transfer processes, natural disaster risks and insurance systems development. The life insurance industry will become increasingly involved in the provision of pension products and services.

- The payments infrastructure will be redefined, as the introduction of Real-Time Gross Settlement (RTGS) will virtually eliminate settlement risk on high value transactions.

- Capital markets will be highly developed and offer liquidity across a wide range of core and exotic financial products to issuers and investors. The combination of high quality infrastructure, highly skilled workforce and developed foreign exchange, debt securities and equity markets will establish a tradition of stability, depth, transparency and product innovation.

- The regulatory framework will emphasize safety and soundness, competition and the protection of consumer interests. Regulators will rely to a much greater degree on international co-operation and effective internal governance structures. With the development of greater disclosure requirements, rating agencies and the wider investment community will closely monitor financial institutions.

- For all consumers of financial services products, transactions will be transparent, with easily understood and timely disclosure of product terms and conditions, risks, and conditions of sale. There will be accessible and effective redress mechanisms.

- The human resource base will comprise a well-educated, highly skilled and multi-lingual cadre of professionals with training in finance, economics, risk management, business, accounting, law, regulation, and information technology.

3.3 The Role of Government

The Vision for the financial sector of Trinidad and Tobago speaks to a Pan-Caribbean Financial Sector that is essentially private sector led and market driven. There is nonetheless a very critical role for the Government to play if this Vision is to be achieved.

Government's role is essentially two-fold, that of a facilitator and a developer. In its role as a facilitator, Government will be required to take a very pro-active approach to the establishment of the legal and regulatory, and institutional infrastructure as quickly as possible. This will require a dedication of resources to the various tasks at hand and a commitment to implementation within schedule.

In its role as developer, the government will participate in the market under special circumstances and conditions; in particular where the market is unable to meet particular social needs, where there are market imperfections or where there might be significant market risks.

Participation may take different forms, including the establishment and nurturing of innovative institutions, as was the case of the Trinidad and Tobago Unit Trust Corporation and the Home Mortgage Bank, or the provision of incentives to facilitate market and institutional development in specialized areas.

SECTION 4.0 RECOMMENDATIONS

If Trinidad and Tobago is to develop a Pan-Caribbean Financial Centre which is internationally competitive and which can propel the development of the country towards the attainment of developed-country status by 2020, it will be necessary to implement the following general and sector-specific policy recommendations:

4.1 General Recommendations

Legislative Framework: The legislative framework should be upgraded to ensure a sound legal basis for all areas of financial sector activity. This framework should encompass rules - that are in conformity with international best practice - for information disclosure, prudential requirements, mergers and acquisitions, electronic finance and standards for corporate governance, as well as rules to safeguard against money laundering and financing of terrorism. The legislative framework should also make provisions for the adoption of International Financial Reporting Standards (IFRS) after consultation with the Institute of Chartered Accountants of Trinidad and Tobago (ICATT).

Financial Reporting Standards: All companies that are engaged in the provision of financial products and services should be required to adopt the IFRS.

Regulatory and Supervisory Systems: The regulatory and supervisory systems for the various segments of the financial sector should be upgraded to provide for the integrated regulation of the sector. In order to give effect to the integrated regulation and supervision of the financial sector, a single Regulatory Authority with the necessary powers and authority should be established. As the financial reforms are gradually introduced, it may be necessary, in the interim, to establish a Regulatory Council as a first step towards the establishment of the single Regulatory Authority.

Regime of Taxation: The taxation regime for the financial sector should be reviewed to ensure that the sector is competitive and that tax induced distortions within the sector are removed.

Telecommunications Infrastructure: The telecommunications sector should be liberalized in order to keep pace with technological developments and with the provision of advanced telecommunication services at competitive prices.

Competition Policy: The development of a competition policy for the financial services sector should be expedited. This policy should encompass rules to deal with anti-competitive behaviour including unfair practices, rules to protect consumers, and standards to promote financial services development in the local industry while complying with international agreements.

Trade Agreements*:* There is need to ensure that commitments under bilateral, regional and international financial services agreements do not adversely inhibit the development of the financial system.

Financial Services Ombudsman*:* The Office of the Banking Ombudsman should be upgraded to that of a Financial Services Ombudsman in order to provide an Alternative Dispute Resolution (ADR) mechanism to the formal legal system. The Office must be appropriately staffed and financially supported by the industries it serves.

Small Claims Court*:* The feasibility of establishing a "small claims court" for settling petty financial services issues that lie outside the jurisdiction of the Financial Services Ombudsman should be explored.

Human Resources*:* A cadre of human resource personnel capable of efficiently managing the financial services sector must be developed. Internationally recognised certification and accreditation requirements for persons involved in the conduct of financial business of an advisory, investment, consultancy or related nature should be instituted.

4.2 Sector-Specific Recommendations

4.2.1 Policy Recommendations for the Banking Sector

1. Accelerate efforts to bring to Parliament the proposals to amend the Financial Institutions Act (1993) that seek to enhance supervision and strengthen the Central Bank's enforcement powers. The major provisions relate to:

    - Supervising a financial institution that is part of a group or conglomerate. The amendment should give the Central Bank:

        - Authority to enforce reporting requirements on a commercial group to which a licensee belongs.

        - Authority to institute cross-border supervision and sharing of information with other regulatory authorities.

        - Power to introduce measures to limit or restrict intra-group transactions beyond the licensee and related parties.

        - Authority to require adequate capital and other prudential requirements to be applied on a consolidated basis.

    - Cross-border supervision to allow sharing of information with foreign regulators and supervising a licensee's branch.

- Reporting of large exposures - This would include not merely commercial loans but lending to insiders and related parties. Risk-related criteria for measuring exposure should be stipulated.

2. Facilitate the development of information vendors, an independent Credit Rating Agency, and an Automated Credit Bureau that would provide information to improve the assessment of risks.

3. Lower the statutory cash reserve requirement for commercial banks in phases to reduce intermediation costs in the banking system and bring it on par with that of the non-banks.

4. Accelerate the movement towards a market-based supervisory framework by:

   - Strengthening corporate governance and risk management capabilities that should be benchmarked against international best practice.

   - Strengthening consolidated supervision of financial conglomerates.

   - Enhancing surveillance of the financial system to provide early warning signals of potential distress.

   - Providing regular and reliable information to the public.

5. Upgrade the Inter-bank payment systems to allow for a more efficient system of payments, clearance and settlement that permits more effective oversight and management of risk.

4.2.2 Policy Recommendations for the Capital Market

1. Strengthen the legal framework governing the securities market by undertaking a comprehensive review and upgrade of the Securities Industry Act (1995) to ensure that the SEC is given effective power to regulate the capital market in accordance with internationally accepted standards. Ensure consistency among all regulations governing activities in the capital markets.

2. Modernise and consolidate the regulatory and supervisory framework in accordance with international best practice, and implement the current recommendations for reform. Specific attention should also be placed on instituting an enforceable take-over code.

3. Codify standards of good corporate governance practice in accordance with international best practice and establish rules to deal with interlocking directorates, voting rights of trustees, and management of collective investment schemes.

4. Introduce rules and regulations in support of principles-based financial reporting in line with international financial reporting standards, after consultation with ICATT.

5. Implement international standards for information disclosure and reporting so as to improve market transparency. Amend the relevant sections of the FIA 1993, the SIA 1995 and Insurance Act, Chap. 84:01 to allow for the effective sharing of information among all local regulatory authorities, as well as with other appropriate regional and international regulatory agencies in order to facilitate effective regulation of institutions operating across markets and borders.

6. Encourage greater use of equity-based financing as an alternative to debt financing.

7. Strengthen the human resource base, management information systems and institutional capacity of institutions within the sector.

8. Implement a structured programme of educating investors, regulators, self-regulatory bodies, and capital market institutions on the rights and responsibilities of all stakeholders.

9. Accelerate efforts to establish an independent Regional Credit Rating Agency.

10. Foster the development of commercial vendors of information.

11. Encourage the development of institutional relationships between the various market actors (regulators, investors, professional intermediaries and producers of services) in Trinidad and Tobago and those in regional and international financial markets.

12. Develop the microstructure of the primary and secondary market for government bonds by widening the primary distribution network for Central Government treasury bills and long-term bonds and redesigning the distribution channels for these securities. Adopt an auction mechanism as the main distribution channel for selling government securities.

4.2.3 Policy Recommendations for the Insurance Sector

1. Revise the insurance legislation and regulations in conjunction with the industry. The revisions should:

    - Provide the Regulator with the necessary powers to intervene where necessary.

    - Be appropriate for the local industry and new complex organizations that are emerging.

- Be appropriate and in line with the Core Insurance Principles of the International Association of Insurance Supervisors which constitute current international best practice.

- Be adequate to deal with the market conduct issues currently facing the industry.

- Require more stringent capitalization, thereby ensuring that only companies that are adequately capitalized and solvent continue operations or enter the market.

2. The Regulator should work together with ICATT and the insurance industry to develop appropriate financial reporting standards for use until such time as the International Financial Reporting Standards for insurance entities become available.

3. Review the basis on which insurance companies are taxed with a view to determining whether the existing taxation regime is fair and consistent with international best practice.

4. Enhance the supervisory system to include a more pro-active approach to risk-based supervision, improved corporate governance, and greater disclosure and information sharing with the public and other sectors of the financial system.

5. Work with national and regional regulators to place more emphasis on the sharing of information to facilitate efficiency in the regulatory process.

6. Investigate the feasibility of establishing an Insurance Fund, financed by the industry, and based on the principle of deposit insurance, to protect policyholders in the event of insolvency of an insurer.

7. Investigate the feasibility of establishing a Motor Insurance Bureau, financed by the industry, to deal with redress for victims of non-insured drivers.

4.2.4 Policy Recommendations for the Pension Industry

1. Consolidate and modernise, where possible and practical, the various pieces of legislation and the fragmented regulations that govern the industry.

2. Execute the regulation and supervision of pensions within an integrated regulatory framework, so as to more effectively regulate the institutions managing these funds.

3. Establish prudential criteria for the management of pension funds. These criteria should involve prudent quantitative and qualitative limits on the types of investments in which pension funds can engage, disclosure requirements

buttressed by financial reporting standards, best practice, corporate governance and fiduciary standards (fit and proper management).

4. Undertake strict enforcement of prudential criteria and information disclosure requirements.

5. Codify the portability of pension rights in law so that it is not left up to the discretion of the rules of individual funds. This will ensure that fund members are not constrained or lose benefits when they switch from one pension fund to another.

6. Ensure that fund managers are capable of implementing the required prudential criteria by adopting the most up-to-date and rigorous standards for benchmarking, portfolio insurance and for measuring and limiting the risk exposures contained in the pension portfolios under their management.

7. Accelerate the harmonization and administrative integration of the Old Age Pension and National Insurance Scheme.

4.2.5 Policy Recommendations for the Mutual Funds Industry

1. Enact legislation that will provide a clearly defined regulatory and supervisory structure for the mutual funds industry. This legislation should map out licensing arrangements, corporate governance standards, disclosure requirements and capital requirements or guarantee funds, and investment guidelines, including on-line investment and investment in offshore funds.

2. Define the roles the CBTT and the SEC will play in the regulation of the mutual funds industry, or bring the regulation of the industry under the proposed single Regulatory Authority for the financial services sector.

3. Bring the operations of the UTC within the ambit of the proposed Mutual Funds Legislation.

4. Encourage fund managers to continue to develop their in-house capacity for market surveillance in order to better evaluate the significance and credibility of third party information.

5. Develop and implement new and appropriate financial reporting guidelines for market participants that are in keeping with the IFRS. This will promote transparency, foster information disclosure and provide standards for guiding decision-making by the regulatory body in determining solvency within the industry.

6. Specify effective prudential requirements for entry into the mutual funds industry.

7. Apply the “fit and proper” criteria to mutual fund managers.

8. Streamline the taxation policies within the mutual funds industry, thereby creating a level playing field for all players.

4.2.6 Policy Recommendations for the Credit Union Sector

1. Upgrade the legislation that governs the activities of credit unions so as to more effectively take account of international best practice in the sector as well as legislative changes in the broader financial system.

2. Draft appropriate rules for mergers and acquisitions while encouraging some degree of consolidation in the sector. Voluntary consolidation should be encouraged as the basis for creating a more competitive entity but, in cases where separate institutions cannot meet prudential standards, regulatory authorities should play a greater role in overseeing an appropriate form of consolidation.

3. Accelerate the development and implementation of relevant criteria based on appropriate prudential (such as the PEARLS ratios) and disclosure requirements, and introduce systems for the continuous monitoring of credit unions. The ability of the Regulator to take decisive and appropriate action against problem institutions should also form part of this framework.

4. Improve the standard of corporate governance in the credit union sector. The process for electing officials should be addressed and fit and proper standards should be set for credit union boards, committee members and managers.

5. Retain the tax-exempt status of credit unions (at the corporate income tax level) so as to encourage the further development of the sector. This status should be reviewed every five years for relevance.

6. Supervision of the Credit Union Sector should be brought under the umbrella of the Ministry of Finance and the Central Bank.

7. Give active consideration to the graduation of the very large credit unions and credit unions that are engaging in non-core activities of a financial nature to the same standard of supervision provided for other financial institutions. Institutions to be graduated should be given a transition period to adjust to the new standards.

4.2.7 Policy Recommendations for the Venture Capital Industry

1. Amend the Venture Capital Act in keeping with the approved recommendations of the Task Force on Venture Capital.

SECTION 5.0 ***Implementation Plan***

Achievement of the vision for the financial system of Trinidad and Tobago will require development of an implementation plan that outlines the major priorities for the financial system's infrastructure and a legislative agenda, supported by an effective implementation schedule. This section outlines the institutional development, legislative agenda, and implementation schedule that are necessary to lay the foundation for the establishment of a Pan-Caribbean Financial Centre.

5.1 Development of the Institutional Infrastructure

In order to improve the efficiency of the operations of the financial system, several changes will need to be made to the existing financial services infrastructure. In the short to medium term, the most important of these will comprise the establishment of a Financial Services Ombudsman, a Credit Rating Agency, an Automated Credit Bureau, a Regulatory Council and a single Regulatory Authority, and the upgrade of the National Payments System.

5.1.1 Establishment of the Office of a Financial Services Ombudsman

The Office of the Banking Services Ombudsman was established in May 2003 to facilitate independent and prompt resolution of complaints raised by customers of commercial banks. Over the course of time, the responsibilities of this Office will be extended to other activities in the financial services industry.

5.1.2 Establishment of a Regional Credit Rating Agency

The Central Bank of Trinidad and Tobago, local commercial banks and other financial institutions that operate in the local and regional market have collaborated to establish a Credit Rating Agency. This agency is expected to be functional before the end of 2004.

The prime objective of the Credit Rating Agency would be to improve the availability and quality of credit information on governments and firms raising capital from financial markets. It is expected to foster greater development of capital markets and the investment climate in Trinidad and Tobago by enhancing access to financial markets and by improving the pricing of capital market placements.

5.1.3 Establishment of an Automated Credit Bureau

The Bankers Association of Trinidad and Tobago is expected to introduce an Automated Credit Bureau in early 2004. This initiative falls within the context of the Secured Transactions Project sponsored by the Multilateral Investment Fund of the IADB, which has as its main objective the establishment of an efficient legal and institutional framework for secured transactions to improve and broaden access to credit services, specifically for small and medium-sized enterprises. The Credit Bureau is expected to maintain a database of information on consumer credit in the financial system and to compile reports on the creditworthiness of individuals. This should reduce credit risk, encourage lower transaction costs for lenders, improve credit terms for borrowers and encourage competitive lending practices.

Draft legislation, the Consumer Fair Reporting Bill**,** which provides for the Central Bank to be the licensing authority for credit bureaus under the proposed legislation, has been circulated to relevant parties for comment.

5.1.4 Establishment of a Regulatory Council and a Single Regulatory Authority

At the present time, none of the Regulators of the financial sector have the legal authority to co-operate and share information. The first step in achieving this involves the regulators in the industry developing an operational framework for creating an appropriate information sharing mechanism.

A Council of Regulators will be established by the end of December 2004 for the purposes of minimizing and managing systemic risks and ensuring stability of the financial system. An initial meeting has been held and draft Terms of Reference are being formulated.

The Council will also ensure that appropriate Memoranda of Understanding are executed when the amendments are made to the various financial legislations; thereby giving each Regulator the legal power to share information.

The Council will also prepare a Draft Paper for Establishing the Single Regulatory Authority with the necessary powers of authority to give effect to full integrated supervision.

5.1.5 Establishment of a National Payments System

An efficient domestic payments system, with proven modern technologies, that services the needs of the domestic financial system, but which also has the potential to link to international payments systems, is indispensable for the development of financial services in Trinidad and Tobago. Recognising the need for providing users with a range of options for making payments, reducing the cost of financial transactions and enhancing the smooth functioning of the financial sector, the Central Bank of Trinidad and Tobago has initiated a project to reform the payments clearance and settlement systems. This reform is aimed at minimizing systemic risks and ensuring that there are modern, fast and accurate tools to manage liquidity and monitor the behaviour of the payments system.

The overall reform involves a number of activities that will be performed by the Central Bank and other participants in the system. The Central Bank will undertake the development of (i) the Real Time Gross Settlement System (RTGS), (ii) the Government Securities Depository (GSD), and (iii) the Inter-bank Funds Trading System. The other components of the Strategic Payments Architecture are (i) the Automated Clearing House (ACH) which is being managed by the ACH Project Review Committee, comprising the CBTT and all the commercial banks, (ii) the Stock Exchange Trading System which is being implemented by the Stock Exchange, (iii) the Central Securities Depository which recently began operations as the TTCD, (iv) other payments systems, (currently LINX and the credit card system) and (v) clearing houses.

These systems would need to be continuously upgraded to take advantage of new technologies as well as to permit consumers and investors, where appropriate, access to on-line services.

5.2 Legislative Agenda

In order to give effect to the recommendations for reform of the financial system so that implementation can be achieved in a reasonable time period, several legislative priorities have been established. This section explores the major legislative priorities for each of the sub-sectors of the financial system.

5.2.1 Banking

Objective of Legislation

A detailed Legislative Drafting Brief to amend the Financial Institutions Act 1993, was prepared by the Central Bank in 2000 and circulated to the banking industry for comment. The legislation is being amended to bring it fully in line with the Core Principles of Effective Banking Supervision as set out by the Basle Committee on Banking Supervision and to ensure consistency with international best practice. The Central Bank's objective is to procure the amendments to the FIA by June 2005.

Core Principles and Amendments

The proposed legislation will, among other things, seek to empower the Central Bank to:

- Conduct effective consolidated and cross-border supervision.
- Share information with other domestic and foreign regulatory bodies.
- Access information from affiliates of licensed institutions.
- Regulate holding companies whose concept will be re-defined under the proposed amendment to the FIA.
- Require licensed institutions ("licensees") to seek the prior approval of the Central Bank to acquire substantial controlling interests in another company (subsidiaries).

- Deal with licensees that, though fully compliant with the legislation, are not financially strong and are experiencing liquidity and other difficulties.

- Impose civil money penalties on licensees for breaching certain provisions of the FIA.

5.2.2 National Payments System

Objective of Legislation

The proposed legislation seeks to establish a legal environment that will support a modern, sound and efficient national payments clearance and settlement system in Trinidad and Tobago. The payments system will also be governed by specific agreements among the system's participants. An appropriate professional assessment of the enforceability of these arrangements is being undertaken.

Core Principles and Amendments

The legislation will be developed to provide more complete regulation by the Central Bank of the payments clearance and settlement system and will address issues related to:

- The Payments System's overnight function.

- Improvement of the payment clearance and settlement systems.

- Finality and irrevocability of payments.

- Interrelations with insolvency laws and procedures..

- Transparency and access.

- Electronic Transfers.

5.2.3 Capital Market

Objective of Legislation

The review of the SIA, 1995 and its By-laws and associated legislation is intended to bring the securities regulatory regime in Trinidad and Tobago to the level of international best practice.

Core Principles and Amendments

Several conceptual and structural changes for securities regulation in Trinidad and Tobago have been recommended. These include:

- The evolution of securities regulation from issuer-based jurisdiction to investor-based and activity-based jurisdiction.
- Separation of the policy-making enforcement and adjudicative functions of the securities regulatory authorities.
- Provision for the Securities Market Tribunal and the suggested amendments to the Companies Act Chap. 81:03 that places "public company" regulation under the supervision of the SEC.
- Treating with competing concerns, which include the emerging state of the securities market, the need to balance market development with investor protection, the expertise and resources available in securities regulation and related fields, and the need for a level playing field among the securities market participants.
- Establishment of By-Laws for Collective Investment Schemes with a mixed disclosure approach and substantive regulation approach.

5.2.4 Insurance

Objective of Legislation

The central objective of the proposed amendments to the Insurance Act is to modernize the insurance sector in line with international best practice by ensuring adequate and appropriate prudential international standards for supervision and regulation of the insurance industry and pension plans.

Core Principles and Amendments

The Core Principles of the proposed legislation are intended to:

- Strengthen the capacity and capability of the regulatory agency to address the complex issues that have developed in the insurance business and mitigate the weaknesses that now afflict the Supervisor's Office.

- Improve the regulatory framework to bring it in line with market imperatives and developments relative to product innovation and corporate restructuring.

- Incorporate current international standards as espoused in the International Association of Insurance Supervisors (IAIS). These regulatory principles have been internationally recognized as being necessary for effective supervision of insurers as well as for providing mechanisms to monitor international operations and cross-border activities. Adherence to these standards also promotes international regulatory consistency, which is an important element in effectively regulating cross-border activity.

- Remove the legislative mechanisms incorporated in the Insurance Act to allow the regulator to act in an appropriately expeditious manner and effectively deal with current weak companies to either restore financial capacity or manage an exit policy.

- Apply consistent regulatory methods and systems to financial services and products and thus eliminate requirements and standards that discriminate between them. This will promote fairness in the market and also reduce opportunities for regulatory arbitrage.

- Reduce systemic risks in the financial system by affording an increased span of control by one regulator over a larger segment of the financial sector.

Among the key areas to be covered by the legislation are licensing of companies; prudential standards; corporate governance; related party transactions; market conduct including consumer protection; corporate transactions (mergers, transfers of business, etc.); financial reporting and records; and the powers of the Supervisor.

5.2.5 Pensions

Objective of Legislation

The proposed new pension legislation is intended to modernize the pension industry by developing and implementing a comprehensive pension regime for Trinidad and Tobago.

Core Principles and Amendments

The proposed new legislation, which will accompany the reformed pension regime, will address a number of core issues in the industry, including:

- Consolidation and modernization of the various pieces of dated legislation.

- Integrated regulation and supervision of the industry.

- Administrative integration of the National Insurance Scheme (NIS) and Old Age Pension (OAP).

- Provisions for the establishment of minimum requirements/benchmarks governing the operations of the industry, including:

    - Portability and transferability.
    - Prudential criteria for the management of pension funds.
    - Fit and proper criteria for fund managers and trustees.
    - Entry and exit criteria.
    - Corporate governance.
    - Reporting requirements.
    - Information disclosure.
    - Financial reporting standards.

- Establish, in consultation with the industry and relevant stakeholders, core principles regarding:

    - Indexation of benefits and contributions.
    - Minimum income replacement ratios.
    - Minimum guaranteed levels of income maintenance in retirement.
    - Treatment of pension funds surpluses and deficits.

5.2.6 Credit Unions

Objective of Legislation

The reform of the Credit Union sector seeks to advance the operations and processes of the sector by bringing it in line with international best practice thereby creating developed, modern and stable institutions that will help to strengthen the financial system of Trinidad and Tobago. The Co-operatives Societies Act, Chap. 81:03, which governs the credit union sector, is outdated and does not effectively address the stability of the sector.

Core Principles and Amendments

The proposed new legislation will focus on the following key issues:

- Consolidate and revamp the existing regulatory and supervisory authorities for credit unions.

- Require the preparation of audited financial statements in accordance with the IFRS, after consultation with ICATT.

- Develop and implement relevant criteria with minimum standards for

    - Mergers and acquisitions.
    - Information disclosure.
    - Financial reporting standards.
    - Corporate governance.
    - Mechanisms for assessing credit-worthiness and risks.
    - Fit and proper criteria for key management and directors.

5.2.7 Venture Capital

Objective of Legislation

In August 2003, Cabinet approved the recommendations of the Task Force on Venture Capital, which seek to amend the Venture Capital Act, 1994. The Chief Parliamentary Counsel (CPC) has prepared draft amendments to the legislation. The principal objective of the amendments is to improve the effectiveness of the venture capital regime.

Core Principles and Amendments

The proposed amendments to the legislation will address the following critical issues:

- Increasing the range of investment instruments in which venture capital companies may invest.

- Removal of the restrictions on the type of shares that could be issued by venture capital companies.

- Removal of the residentiary requirements of directors.

- Inclusion of fit and proper requirements for fund managers.

- Increasing the equity share capital of venture capital companies.

- Deletion of the minimum capital requirement.

- Amendment of the ratio of investment requirements from 50% by the end of the second year to 75% by the end of the fourth year.

- Deleting the categories of business involving primary resource extraction (including oil and natural gas extraction) and the manufacture of petrochemicals from the list of prohibited categories of investment.

- Removal of the restriction on the size of a Qualifying Investee Company (QIC) and increasing the limit on the issued capital of a QIC from TT$3 million to TT$50 million.

5.3 Implementation Schedule

The implementation schedule identifies priority dates by which activities should be completed if effective modernization of the financial services industry is to be achieved.

Implementation Schedule for Activities in the Financial Sector

Task Name	End Date	Implementing Agency
All Sectors		
Create Office of Financial Services Ombudsman	DEC 2004	**CBTT**
Establish an Interim Regulatory Council	DEC 2004	**CBTT**
Establish a Single Regulatory Authority	DEC 2006	**CBTT**
Banking Sector		
Commence Operations of the CRA	OCT 2004	**CARICRA/CBTT**
Commence Operations of the ACB	OCT 2004	**CBTT/BATT**
Reduce Statutory Cash Reserves Requirement for Commercial Banks	MAR 2005	**CBTT**
Amend the FIA 1993	JUN 2005	**CBTT**
Upgrade Inter-Bank Payment Systems	MAR 2006	**CBTT**

Implementation Schedule for Activities in the Financial Sector cont'd

Task Name	End Date	Implementing Agency
Capital Market		
Foster Development of Commercial Vendors of Information	JUN 2004	**SEC**
Commence Electronic Trading on the Stock Exchange	SEP 2004	**SEC**
Review and Upgrade SIA, 1995	APR 2005	**SEC**
Modernize the Regulatory and Supervisory Framework	JUN 2005	**SEC**
Strengthen the SEC	AUG 2005	**SEC**
Improve Standards for Good Corporate Governance	DEC 2005	**SEC**
Develop the Micro-structure of Market for Government Bonds	DEC 2005	**SEC**
Develop Institutional Relationships among Market Actors	DEC 2005	**SEC**
Enhance Investor Education Programme	ONGOING	**SEC**
Insurance Sector		
Investigate the Feasibility of Establishing an Insurance Fund	MAR 2005	**CBTT/ATTIC/ MOF**
Investigate the Feasibility of Establishing a Motor Insurance Bureau	MAR 2005	**CBTT/ATTIC/ MOF**
Implement Appropriate IFRS in Consultation with ICATT	JUN 2005	**ICATT/CBTT/ ATTIC**
Review Current System of Taxation	JUN 2005	**MOF/CBTT**
Implementation of Modern Supervisory Practices	DEC 2005	**CBTT**
Procure Comprehensive Amendments to the Insurance Act	DEC 2005	**CBTT/MOF**
Pension Industry		
Develop Prudential Criteria for the Management of Pension Funds	DEC 2004	**CBTT**
Enforce Information Disclosure Requirements	DEC 2004	**CBTT**
Consolidate and Modernise Pension Legislation	DEC 2005	**MOF**
Codify the Portability of Pension Rights in Law	DEC 2005	**MOF**
Establish the Integrated Regulatory Framework	DEC 2005	**CBTT**
Harmonize and Integrate the OAP and NIS	DEC 2005	**MOF**

Implementation Schedule for Activities in the Financial Sector cont'd

Task Name	End Date	Implementing Agency
Mutual Funds Industry		
Incorporate Effective Financial Reporting Standards in the Regulatory & Supervisory Framework for Mutual Funds	APR 2005	**SEC**
Develop Investment/Mutual Funds Legislation	NOV 2005	**SEC**
Develop Capacity for Market Surveillance	NOV 2005	**SEC**
Credit Union Sector		
Draft Rules for Mergers and Acquisitions	DEC 2004	**MOF**
Transfer Supervisory Authority to MOF/CBTT	JAN 2005	**MOF/CBTT**
Develop Prudential Standards for CUs	JUN 2005	**MOF**
Improve Standards of Corporate Governance	JUN 2005	**MOF**
Review the Principle of Graduation of CUs	JUN 2005	**MOF**
Upgrade Legislation Governing CUs	OCT 2005	**MOF**
Venture Capital Industry		
Amend the Venture Capital Act	JUN 2004	**MTI/MOF**

ACB - Automated Credit Bureau
ATTIC - Association of Trinidad and Tobago Insurance Companies
BATT - Banker's Association of Trinidad and Tobago
CARICRA - Caribbean Credit Rating Agency
CBTT - Central Bank of Trinidad and Tobago
CPC - Chief Parliamentary Counsel
CRA - Credit Rating Agency
ICATT - Institute of Chartered Accountants of Trinidad and Tobago
MOF - Ministry of Finance
MTI - Ministry of Trade and Industry
SEC - Trinidad and Tobago Securities and Exchange Commission

Annex 1A

Terms of Reference - Green Paper Committee

By Cabinet Minute No. 480 of March 21, 2002, the Cabinet of the Government of Trinidad and Tobago agreed to the appointment of a committee ("**Green Paper Committee**") to review the financial system of Trinidad and Tobago. This decision was taken in view of the continued modernization and liberalization of the domestic economy, especially the financial sector. The Cabinet noted that since the onset of liberalization in 1993, the financial system had become more developed in terms of both its institutional mix and range of financial instruments. The Cabinet, therefore, felt it was opportune to identify the key players, design strategies to promote the sector's development and outline regulatory structures to ensure its stability.

The Terms of Reference of the Committee are to prepare a report which reviews the financial sector of Trinidad and Tobago and to make recommendations for a more efficient, integrated and dynamic sector that allows for the rapid development of the domestic economy, paying specific attention to the following sectors:

- The Banking Sector
- The Capital Market
- The Trinidad and Tobago Securities and Exchange Commission
- The Trinidad and Tobago Stock Exchange
- The Insurance Industry
- The Pension System
- The Mutual Funds Industry
- The Credit Union Sector
- The Venture Capital Incentive Programme

A list of the members of the Committee is presented in Annex 2A.

The Green Paper Committee met over the period March to September 2002 and produced a report, which was tabled in the Houses of Parliament in May 2003 and subsequently circulated for public comment.

Annex 1B

Terms of Reference - White Paper Committee

In October 2003, Cabinet agreed to the appointment by the Minister of Finance of a Committee ("**White Paper Committee**") with the following Terms of Reference:

- To review the Report of the Committee (Green Paper Committee) appointed by Cabinet to Review the Financial Sector in Trinidad and Tobago, which was laid in Parliament on May 21, 2003 as a Green paper.

- To strengthen the Report to a level whereby it might be converted to a White Paper on the reform of the financial sector in Trinidad and Tobago.

- To develop an implementation plan and schedule for the recommendations emanating from the revised Report.

- To deliver the revised Report and implementation plan and schedule to the Minister of Finance not later than the end of December 2003. The Committee deadline was subsequently extended to January 31, 2004.

Lists of members of the White Paper Committee and persons co-opted to assist the Committee are provided in Annexes 2B and 2C, respectively.

Annex 2A: LIST OF MEMBERS OF THE GREEN PAPER COMMITTEE

Ms. Monica Clement	**Mr. John Jardim**
Dr. Claude Denbow S.C.	**Ms. Joan John**
Mr. Vishnu Dhanpaul	**Mr. Claude Musaib-Ali**
Mr. Martin Guevara	**Mr. Gerard Pemberton**
Mr. Lyndon Guiseppi	**Mr. Subhas Ramkhelawan**
Dr. Ralph Henry	**Dr. Ronald Ramkissoon**
Mr. Leroy Mayers (Chairman)	

ANNEX 2B: LIST OF MEMBERS OF THE WHITE PAPER COMMITTEE

Name	Institution
Mr. Kamal Mankee (Chairman)	Permanent Secretary Ministry of Finance
Ms. Joye Donaldson	Secretary to the Committee Divestment Secretariat Ministry of Finance
Dr. Terrence Farrell	Chairman Macro-Economy and Finance Sub-Committee, Vision 2020
Dr. Penelope Forde	Manager, Research Department Central Bank of Trinidad and Tobago
Mrs. Catherine Kumar	Inspector of Banks Central Bank of Trinidad and Tobago
Ms. Radica Maharaj	Manager, Legal Department Central Bank of Trinidad and Tobago
Dr. Shelton Nicholls	Deputy Governor Central Bank of Trinidad and Tobago
Mr. Gerard Pemberton	Group Managing Director Development Finance Limited
Dr. Ronald Ramkissoon (Declined)	Senior Economist Republic Bank Limited
Mr. Dave Seerattan	Research Fellow Caribbean Centre for Monetary Studies, University of the West Indies, St. Augustine Campus
Mr. Selby Wilson	Chairman Financial Services Sub-Committee, Vision 2020

ANNEX 2C: LIST OF PERSONS CO-OPTED TO ASSIST THE WHITE PAPER COMMITTEE

Mr. Michael Craigwell	CLICO Investment Bank
Mr. Jason Hagley	TIDCO
Ms. Lavaughn Pritchard	Project Unit Ministry of Finance
Mr. Anston Rambarran	Research Department Central Bank of Trinidad and Tobago
Prof. Ramesh Ramsaran	Professor, Institute of International Relations, University of the West Indies (UWI), St. Augustine Campus
Mr. Kelvin Sergeant	Director, Research Securities and Exchange Commission
Ms. Sandra Swan-Daniel	Research Department Central Bank of Trinidad and Tobago
Mrs. Althea Thompson	Bank Inspection Department Central Bank of Trinidad and Tobago