

**TRINIDAD: NON-REIMBURSABLE TECHNICAL COOPERATION TO
STRENGTHEN
BANK SUPERVISION**

(TC-98-02-332)

EXECUTIVE SUMMARY

EXECUTING AGENCY: Central Bank of Trinidad and Tobago

PROJECT SPECIFIC OBJECTIVES: The objectives of the proposed non-reimbursable technical cooperation are to strengthen the supervisory capacity of the Department of Bank Supervision (DBS) within the Central Bank of Trinidad and Tobago, and to provide analytical support to the Central Bank as it spearheads the country's efforts to formulate strategies to achieve stronger and more coherent supervision across the entire financial sector.

COST AND FINANCING:	MIF:	US\$ 720,000 (WINDOW I)
	Beneficiary:	US\$ 480,000
	Total:	US\$1,200,000

EXCEPTIONS TO BANK POLICY: None

SPECIAL CONTRACTUAL CONDITIONS: As a condition prior to first disbursement, the Central Bank of Trinidad & Tobago must submit for the Bank's approval evidence that it has:

- a. appointed the director of the TC program, and
- b. prepared an initial action plan of activities to be carried out during the first six months of the program.

I. COUNTRY AND PROJECT ELIGIBILITY

- 1.1 The MIF Donors' Committee declared Trinidad & Tobago eligible for all forms of MIF financing on December 11, 1993 based on a memorandum of country eligibility prepared by the Bank.
- 1.2 The financing of this project for strengthening bank supervision is consistent with the general MIF objective of encouraging countries to adopt development strategies based on sound economic policies aimed at promoting greater private investment. The project is also fully compatible with the eligibility criteria of the Technical Cooperation Facility as set forth in the Agreement Establishing the MIF, Article III, Section 1(e)(1), which establishes that Facility resources may be used to support sound prudential financial system safeguards, including accounting and disclosure standards, and institutions to administer them.

II. BACKGROUND

- 2.1 Financial markets in Trinidad & Tobago are increasingly dynamic and have become more closely linked to foreign markets. For example, banks are entering into financial activities which are either more complicated (e.g. derivatives), span country borders (e.g. foreign branches), or fall outside the area of traditional commercial banking (e.g. insurance products and securities). Bank supervision in Trinidad & Tobago, while carried out competently, has not been able to keep pace with these developments.
- 2.2 In response to the current situation, the Central Bank has highlighted several areas in which it is working or intends to improve its bank supervision function. First, proposals have been made for amendments to the 1993 Financial Institutions Act to enable the Department of Bank Supervision (DBS) to deal more effectively with recent developments in the financial sector. Consolidated supervision and cross-border exchange of information are two areas receiving particular attention. The amendments, which will help ensure compliance with the Basle Committee's 25 Core Principles for effective bank supervision, are to be laid before Parliament shortly and are expected to be passed by October 1998. Second, a unit has been established within the DBS to, *inter alia*, conduct mandatory biennial reviews of the adequacy of existing supervisory policies, practices and legislation. Third, the Department is applying a risk-based approach to on-site examination and plans to extend this to off-site surveillance as well.
- 2.3 Despite these efforts, challenges remain. Deficiencies in information technology at the Central Bank translate into inefficiencies in the supervision process. The entry of banks into insurance and securities products is another problem, perhaps even more grave. The institutional and legislative framework in Trinidad has established concrete divisions between banking, insurance and securities supervision. Specifically, the Department of Bank Supervision within the Central Bank is responsible for banking supervision, the Ministry of Finance is responsible for insurance supervision, and a newly created Securities and Exchange Commission is responsible for securities regulation. There has been limited cooperation between these agencies, creating opportunity for regulatory arbitrage in the financial sector.

III. PROJECT OBJECTIVES AND BASIC COMPONENTS

A. Objectives

- 3.1 The objectives of the proposed non-reimbursable technical cooperation are to strengthen the supervisory capacity of the Department of Bank Supervision within the Central Bank of Trinidad and Tobago, and to provide analytical support to the Central Bank as it spearheads the country's efforts to formulate strategies to achieve stronger and more coherent supervision across the entire financial sector.

B. Project Components

- 3.2 The proposed technical cooperation would complement legislative reform efforts by financing: (i) training in emerging areas of bank supervision, (ii) improved information technology, and (iii) strategy formulation to enable the DBS to adapt to the changes occurring in the financial sector. A full description of and detailed budget for these project components is available in the project files.

1. Training component

- 3.3 The Bank Inspection Department staff members have acquired the skills for traditional bank supervision and continue to update these skills through annual training programs, both locally and abroad. The value-added of the proposed training program derives from the exposure and depth that will be provided in new, emerging areas of bank supervision. The expectation is that the proposed courses will have a demonstration effect, with the best elements incorporated into the DBS's standard training upon completion of the project.
- 3.4 The proposed training would be targeted primarily toward the 37 professional staff of the Bank Inspection Department. In addition, the Inspector of Banks would invite the participation of selected representatives of other regulatory agencies in the financial sector, namely the Office of Insurance Supervision and the Securities Exchange Commission. While an inherent benefit would accrue to the course participants from these other agencies, the main benefit in terms of the proposed project would be to create a shared knowledge base across the regulatory agencies in the financial sector, improve communication between them and thus facilitate the supervisory work of the DBS.
- 3.5 A total of 14 training initiatives have been identified, grouped into five broad categories as indicated below. Detailed terms of reference for each course would be prepared as a first step in project implementation.

a. Organization and performance of the financial system

- 3.6 The understanding of the interactions between the financial system and the rest of the economy represents a very challenging task for examiners. Monetary and fiscal policies may impact on the performance of the banks significantly. In addition, the developments taking place in capital markets and activities in areas of non-traditional financial intermediation can affect the stability of banks. Four courses would be offered to enhance understanding of the

impacts of the macroeconomic environment and capital markets development on risks undertaken by banks.

b. Consolidated supervision

- 3.7 Trinidad and Tobago is experiencing an increasing conglomeration of financial intermediation activities, combined with an expansion of offshore intermediation by financial institutions. In addition, banks are engaging in the mutual fund business. Consequently, DBS staff members require training to allow them to cope with this new environment of financial intermediation. Two courses would be offered.

c. Internal control

- 3.8 DBS assessment of the quality of internal controls at financial institutions is a very important element in assuring an efficient management of risk. This task is performed by banks' internal auditors, however DBS examiners need to be well prepared to evaluate this crucial activity. Examiners must develop the ability to apply internal control examination concepts consistently to supervised banks. To achieve this objective, two courses would be offered.

d. Risk management

- 3.9 Currently market risk is manageable in Trinidad and Tobago as banks are funded primarily by stable retail deposits. However, it is important that DBS training focus not only on current risks but anticipate future developments. Two courses would be offered.

e. Specialized advanced courses

- 3.10 This part of the training program would allow selected senior examiners to participate in international courses, seminars and conferences focused on specific topics. As this part of the program is targeted to a few members of DBS staff, it would not be cost effective to provide training in Trinidad and Tobago for this limited number of participants. Expenditures on these training activities constitute a small portion of the total cost of the proposed program. Areas of interest include: money laundering counter measures, mutual funds, and emerging issues in bank supervision.

2. Information technology component

- 3.11 The Department of Bank Supervision has certain urgent needs in the area of information technology (IT) which must be addressed to improve staff productivity and to keep pace with escalating demands in the sector. In areas where the Central Bank has already diagnosed its immediate IT needs, the project would support the acquisition and installation of new equipment and software. Specific requirements have been identified in the following areas: upgraded off-site economic analysis software to improve the Early Warning System which monitors the health of supervised institutions; more advanced computer hardware for off-site and on-site bank examiners; new software to facilitate on-site inspections; and information technology and audiovisual equipment to equip on-site training facilities at the Central Bank.

3. Strategy formulation and definition of future requirements

- 3.12 The third component of the program would assist the Central Bank to define further its strategy for improving financial sector supervision as a whole. Specifically, this component would finance the preparation of policy briefs or other consultant reports required to define and implement the Central Bank's strategy in the areas discussed below. Individual consultants, teams of consultants or consulting firms would be hired to carry out the tasks. Detailed terms of reference would be prepared as a first step in project implementation.

a. Future training requirements

- 3.13 Based on an evaluation of the training program carried out with support from this program, as well as the experience of the ongoing training activities of the DBS, a consultancy would determine the further instructional requirements of the department. A preliminary curriculum would be developed which would specify the content and sequence of the courses to be offered.

b. Future information technology requirements

- 3.14 In addition to the specific IT activities supported by this program, the DBS requires consulting expertise to assist its staff in defining longer-term information technology needs. Technical experts would be contracted to evaluate improvements made to the DBS's Information Technology capacity by the program and to assess further IT requirements in light of the evolving conditions in the domestic and foreign financial markets.

c. Regulation of the financial services sector

- 3.15 Consolidated and cross-border supervision is increasingly essential, given the rapid growth and expansion of banking conglomerates in recent years. As noted above, proposed amendments to the Financial Institutions Act are under active consideration. This component of the proposed project initially would provide advice to the Central Bank on the implementation of these new legislative provisions, and later would a review of the continuing adequacy of the supervision framework in the financial sector.

d. Policy formulation unit

- 3.16 The Central Bank's current capacity for policy formulation across the financial services sector is limited. Once the Bank defines how and where policy formulation activities will be carried out, the proposed MIF program would provide consulting services to assist in identifying regulatory gaps in the financial sector, evaluating country risk exposures across the financial system, and evaluating contagion risk where licensees are part of a conglomerate with non-financial affiliates.

e. Publication of prudential ratios

- 3.17 The Research Department of the Central Bank currently publishes global data on the banking system. However, to improve regulation within the market itself, the DBS is interested in

increasing the transparency and dissemination of prudential information on licensed financial institutions. The proposed MIF program would support the DBS on these issues.

- 3.18 A number of proposals for further work are expected to result from the consultancies in the five areas described above. Those proposals considered to be a priority would be implemented separately, possibly with external financing.

IV. EXECUTING AGENCY AND MECHANISM

- 4.1 The Central Bank of Trinidad & Tobago would be the executing agency with full responsibility for planning, organization, coordination management, monitoring and supervision of the project. The Department of Bank Supervision would be the direct beneficiary. The DBS would prepare terms of reference, select successful bidders, verify progress of work and authorize payments. The Financial Administration Department of the Central Bank would manage the project accounts, including the receipt of funds from the Bank and disbursement to vendors and consultants. The DBS and the Financial Administration Department would submit documentation to the Bank for review and approval following normal MIF procedures, as indicated in the annexes to the TC Program Agreement. This administrative capacity is currently in place and project execution can begin once operative terms of reference are prepared.
- 4.2 The Project Team would periodically visit the executing agency to assess progress on the project. At the conclusion of the project, a Project Completion Report will be prepared. The report will cover the issues indicated in the logical framework and will draw, in part on the consultant evaluations of the training and IT components as noted in paragraphs 3.13 & 3.14 respectively.

V. COST AND FINANCING

- 5.1 In broad terms the cost and financing of the proposed program is presented in the following table. The counterpart contribution for the technology component is expected to be entirely in cash. Detailed budgets of each of the project components are available in the project files.

Summary Budget (in US Dollars)

	MIF	Counterpart	Total
1. Training	336,500		336,500
2. Technology	180,000	470,000	650,000
3. Strategy formulation	149,500		149,500
4. Contingencies	54,000	10,000	64,000
Total	720,000	480,000	1,200,000

VI. PROJECT JUSTIFICATION AND RISKS

A. Justification

- 6.1 The financial sector in Trinidad is evolving rapidly, with banks increasingly involved in more complex and cross-border activities. The proposed technical cooperation would support the Bank Inspection Department as it seeks to adapt to these changes, by financing training, improved technology, and policy advice for the Central Bank as it defines its strategy to achieve stronger and more coherent supervision across the entire financial sector.

B. Compatibility with other Bank programs

- 6.2 In 1993 the Bank approved a US\$80 million Investment Reform Program for Trinidad & Tobago (loans 758-759/OC-TT), which is currently in execution. The financial sector reform component of the ISRP includes provisions to modernize the companies and securities industry legislation, and provided for creation of a new Securities Exchange Commission. This Commission is receiving limited technical assistance from the ISRP. SEC staff will be able to participate in some of the training activities to be offered by the proposed Department of Bank Supervision MIF program. By the same token DBS staffers will become more familiar with securities market oversight issues and how they relate to bank supervision.
- 6.3 In January 1998, the MIF approved a US\$1.3 million technical cooperation to support regional training initiatives for financial sector supervisory personnel throughout Latin America and the Caribbean (TC-97-05-453-RG). The proposed technical cooperation with the Central Bank of Trinidad & Tobago would complement the regional TC by strengthening those deficiencies which are country-specific to Trinidad.

C. Risks

- 6.4 The primary risk to the proposed project is a loss of personnel in the Bank Inspection Department, subsequent to provision of the financed training. Salaries in the DBS are less than competitive with the private sector, and several experienced personnel have left in recent years. This risk will be partially mitigated with the expected improvements in compensation resulting from ongoing negotiations between the Central Bank and its staff union, expected to conclude by July 1998. Separately, the DBS is considering formulation and implementation of a policy to require staff to remain on the job for one year after receipt of every three weeks of training or to reimburse the department for the cost of the training.
- 6.5 At the macro level there is the risk of disruptions to the financial system, and therefore to the DBS and to the successful conclusion of the project. These disruptions could arise from external shocks, poor economic policy, and/or abuses of the system by multilateral financial conglomerates. The risks are mitigated respectively by a government fiscal and monetary policy which places a premium on stability, by continuing efforts to diversify and create

higher valued added exports, and by the legislation currently before Parliament which will enable the authorities to better monitor the activities of financial institutions operating in Trinidad & Tobago.

VII. PROJECT PERFORMANCE CRITERIA

- 7.1 The project performance criteria and benchmarks are presented in the logical framework attached. The Project Completion Report will evaluate the execution of the operation and its various components against these benchmarks.

VIII. EXCEPTIONS TO BANK POLICIES AND PROCEDURES

- 8.1 No exceptions to Bank policies and procedures are requested for this operation.

IX. SPECIAL CONTRACTUAL CONDITIONS

- 9.1 As a condition prior to first disbursement, the Central Bank of Trinidad & Tobago must submit for the Bank's approval evidence that it has:
- a. appointed the director of the TC program, and
 - b. prepared an initial action plan of activities to be carried out during the first six months of the program.
- 9.2 The contract must also establish conditions to ensure monitoring and evaluation of the program, submission of duly audited financial statements, and compliance with the Bank's procedures for the procurement of goods and the hiring of consulting services.

LOGICAL FRAMEWORK
TECHNICAL COOPERATION TO STRENGTHEN BANK SUPERVISION IN TRINIDAD & TOBAGO

	OBJECTIVES	INDICATORS	MEANS OF VERIFICATION	ASSUMPTIONS
	To strengthen the financial sector in Trinidad & Tobago.	A more stable financial services sector, measured in terms of improved prudential ratios, enhanced efficiency and lower risk profiles.	Published financial sector performance data.	Sound macroeconomic
	To strengthen the supervisory capacity of the DBS.	<p>Increase the frequency of on-site inspections to once every 18 months.</p> <p>Off-site inspection procedures expanded to cover new products and improved through enhanced analytical capability.</p> <p>Issuance of appropriate and timely guidelines and regulations.</p> <p>Corrective recommendations made within one month of problem identification.</p> <p>Enhanced quality reports completed by DBS within 2 weeks of scheduled completion.</p> <p>Quarterly publication of prudential ratios to increase transparency in the financial sector.</p> <p>New techniques in consolidated supervision applied continuously.</p>	<p>DBS inspection reports.</p> <p>New financial regulatory guidelines and legislation.</p> <p>Other reports of DBS, SEC and Office of Insurance Regulation.</p>	<p>Banking sector as most important component of financial services in Trinidad.</p> <p>Central Bank most appropriate regulatory entity to address the financial conglomerate issues threatening the stability of the financial sector.</p> <p>DBS recommendations and implemented by parts of government</p>

	OBJECTIVES	INDICATORS	MEANS OF VERIFICATION	ASSUMPTIONS
S	<p>Training completed for all DBS examiners and selected representatives of other financial regulatory agencies in 14 emerging areas of bank supervision.</p> <p>Information technology installed and functioning.</p> <p>Future requirements identified and strategies formulated in key policy areas.</p>	<p>Fourteen appropriate training courses (10 in-country and 4 abroad) delivered to all DBS examiners and selected regulators from the SEC and Supervisor of Insurance to the satisfaction of the executing agency.</p> <p>34 computers/peripherals/audio-visual devices and 5 software programs acquired.</p> <p>2 training courses/workshops provided in use of new software.</p> <p>5 consultant reports completed by end of project.</p>	<p>Ex-post training reports of instructors.</p> <p>Student course evaluations.</p> <p>Site inspection of equipment and software.</p> <p>Accounting records.</p> <p>Consultant reports.</p>	<p>Financial regulators at level of preparation able to internalize DBS personnel already in use of new equipment.</p> <p>Stability and adequacy of regulatory personnel time.</p> <p>Processing of policy at executing agency, acceptance in other government of sub policy recommendations.</p>
ES	<p>Hire consultants to carry out training courses.</p> <p>Acquire and install equipment and software.</p> <p>Provide training in use of software.</p> <p>Hire consultants to provide policy advice.</p>	Budget	Accounting records of Central Bank's Finance and Administration Department	<p>Appropriate consultants identifiable by DBS available on a time under terms of project agreement.</p> <p>Equipment available under terms of project and deliverable to DBS delay.</p> <p>Financial sector regulatory available for course participation.</p>

PROPOSED RESOLUTION

TRINIDAD AND TOBAGO. TECHNICAL COOPERATION. SUPPORT OF BANKING SUPERVISION

The Donors Committee of the Multilateral Investment Fund

RESOLVES:

1. That the President of the Inter-American Development Bank, or such representative as he shall designate, is authorized, on behalf of Multilateral Investment Fund, to enter into such agreements as may be necessary with the Republic of Trinidad and Tobago and to adopt such other measures as may be pertinent for the execution of the plan of operations referred to in Document MIF/AT- _____, with respect to a technical cooperation in support of banking supervision.

2. That up to the amount of US\$720,000 is authorized for the purpose of this resolution, chargeable to the Technical Cooperation Facility of the Multilateral Investment Fund.

3. That the above mentioned sum is to be provided on a non-reimbursable basis.