MSB Roundtable 2010
"Managing Risk for Growth & Development"

Mona Visitors' Lodge & Conference Centre
University of the West Indies, Mona

Address

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Perspectives on Managing Risk for Growth and Development

Ladies and Gentlemen,

I would like to commend the Mona School of Business, the Department of Mathematics of the University of the West Indies and the Caribbean Association of Actuaries for organizing this forum at a time when the world is focused on issues related to the financial stability and the enhancement of risk management. It is also a critical time for Jamaica for all the reasons you already know. I believe that our discussions will yield interesting ideas and proposals on how best to render Jamaica's financial system more efficient, stable and resilient and how to improve our risk management systems to advance the country's growth and development.

Let me begin by emphasizing the critical importance of good risk management for the each firm, its industry and the economy as a whole and say that an efficient risk management system is one of the key ingredients for increasing the productivity of investment in Jamaica. Financial markets promote economic growth by channeling capital to the entrepreneurs with high-return projects. A robust and stable financial system capable of directing capital to its most efficient use is therefore a necessary condition for economic growth. The efficient allocation of capital underlies economic efficiency, international competitiveness, and economic stability. The level of efficiency of capital allocation derives in part from sound risk management.

As a financial system supervisor, the Bank of Jamaica is committed to facilitating sound risk management in the financial system. Our responsibilities are discharged by focusing on both firm-specific and system-wide elements, both of which support overall macroeconomic stability and growth.

From the perspective of the central bank, therefore, the early identification and measurement of risk, the development and enforcement of sound liquidity risk management practices, good corporate governance and risk control are the critical components of sound risk management.

The global financial crisis demonstrated by its absence the importance of good macro-level surveillance in identifying potential risks that might be developing in the economy – risks that could endanger financial stability and threaten the broader economy. Recall that the crisis had its origins in an abundance of credit, in steadily higher risk-taking by market participants and in a general lack of sound oversight on the part of some banks, some companies and some authorities.

Generally, financial intermediaries play a vital role in facilitating growth and economic development by pooling household savings and channeling them to the real sector. They also economize on information costs associated with the monitoring of investment risk and minimize uncertainty about rates of return. Indeed, countries with financial intermediaries which are better at acquiring information and more adept at implementing and enforcing corporate governance principles in order to increase investor participation as well as manage risk typically grow faster than countries with less developed financial systems. Jamaica's financial intermediaries can therefore increase the efficiency of investments and improve the potential for growth by improving their risk management capabilities.

A stable macroeconomic framework promotes a positive relationship between financial development and economic growth and therefore the Bank's efforts to maintain macroeconomic stability is closely tied to its responsibility for financial system stability. As evidenced by the recent global crisis, systemic threats to the financial system have the potential to precipitate economic crises which can undermine the ability of the financial system to allocate resources and mitigate risks effectively.

That being said, the Bank of Jamaica is well aware of the need to acquire further legal authority to extend its financial stability function to include non-bank financial institutions. In this regard, the Government is committed to establishing the necessary legal framework to underpin the central bank's responsibility for overall financial system stability. This is to be done through amendments to the Bank of Jamaica Act. (See attachment for detailed proposals)

The amendments to the Act should include, among other things, the legal authority to ensure, by various specified means, the stability of the financial system, to establish codes and standards for the discharge of its financial stability function and to use the Bank's lender-of-last-resort capabilities for the purpose of promoting system-wide stability.

The Bank of Jamaica will also strengthen its institutional arrangements in accordance with the expanded financial stability function. In this regard, the Bank has already taken measures to enhance the surveillance of commercial banks especially with regard to the monitoring of risks to ensure a better alignment of regulatory capital requirements with risk.

Over the past few years, the Bank of Jamaica has conducted routine 'top-down' stress tests to check the adequacy of the capital buffer to sustain the adverse impact of unexpected shocks. These tests use banking system prudential data covering market, liquidity, interest rate, foreign exchange rate and credit risks for each banking institution.

In addition, the Bank has taken steps to develop a comprehensive inventory of forward-looking analytic and risk assessment models to identify and monitor risks to overall banking system stability.

The Bank is currently strengthening its financial stability framework to include the monitoring of risk exposures of non-bank financial institutions and the assessment of the robustness of their capital adequacy. This will enhance its ability to hold systemically important intermediaries to standards commensurate with their importance in the financial system, to spot emerging risk and to apply regulatory authority to require the intermediary to promptly address these risks. Regulatory requirements in these cases could be, for example, to strengthen capital adequacy, improve risk management and controls or limit concentration exposures or counterparty relationships. Consequently, the Bank's financial stability role could involve assessing the quality and relevance of financial institution's proprietary risk management systems rather than requiring homogenous system-wide controls.

Another important development for 2010, will be the passing into law of the Credit Reporting Act to be followed by the licensing and supervision of credit bureaus by the Bank of Jamaica.

The licensing and supervision of credit bureaus by the Bank of Jamaica will reduce retail credit risks and credit risk evaluation costs to financial intermediaries. This will enable them to reduce their interest spreads and execute a prudent expansion of their lending portfolios.

The inadequacy of information sources about individual credit histories has supported traditionally high interest rate spreads in the local financial sector. This lack of adequate information has limited the effectiveness of the financial intermediaries in allocating financial resources to their most efficient use. Consequently, there have been relatively low loan-to-deposit ratios in the banking system and a low level of private sector credit as a percentage of GDP compared to more developed economies.

The establishment of credit bureaus will provide the means for financial intermediaries to improve their internal credit assessment capabilities and therefore their soundness and profitability. Specifically, greater access to detailed credit information will allow institutions to employ more sophisticated credit risk evaluation techniques to bolster their credit assessment capabilities. These techniques will, for instance, allow institutions to segment borrowers into homogenous categories to more accurately 'score' or rate them according to their credit default probabilities.

I am confident that all financial system participants, who will benefit from this facility, will support the successful passing of the Credit Reporting Act when it is considered by Parliament this year.

Let me conclude by saying that the Bank of Jamaica is taking the necessary steps to build a strong and resilient financial system by seeking to make financial institutions more robust against the impact of adverse shocks. Strengthening the financial system does not imply that its soundness is in doubt. What it implies is that our financial institutions are being set up to become more efficient and effective in the allocation of financial resources in support of sustainable growth and development.

Thank you.