
**CONSULTATIVE PAPER ON THE
CONSOLIDATION OF NATIONAL BANKS IN THE
EASTERN CARIBBEAN CURRENCY UNION**



June 2018

EASTERN CARIBBEAN CENTRAL BANK

CONSOLIDATION OF NATIONAL BANKS IN THE ECCU

1.0 ACTION REQUIRED

The citizens of the Eastern Caribbean Currency Union (ECCU) are invited to **provide feedback** on this Consultative Paper on consolidation of the national banking sector in the ECCU.

2.0 KEY MESSAGES

- a) National banks have played an important role in the development of countries in the ECCU and ought to be strengthened through consolidation to continue to play this important role;
- b) The most compelling factors for the consolidation of the national banking sector are: (i) enhancement of financial stability; (ii) growth in the ECCU; and (iii) the provision of modern services to customers at competitive prices in a dynamic operating environment;
- c) The requirements of the modern Banking Act combined with emerging international standards such as the International Financial Reporting Standards (IFRS) 9, Basel II and III the compliance and dynamic developments in Anti-Money Laundering/Combating Financing of Terrorism (AML/CFT) present a strong case for the deepening and strengthening of the national banking sector through consolidation;
- d) The national banking sector is challenged regarding issues such as loss of correspondent banking relationships; capital adequacy; operational efficiency; profitability and returns on investment; risk management; and corporate governance;
- e) Banking services are costly to deliver and banks worldwide are being driven to revamp their business models to deal with regulatory developments and existing and new competition (including financial technology firms);

- f) Notwithstanding the amalgamation initiatives within the international banking sector, such as CIBC/Barclays Bank Plc and RBC/RBTT, and more recent amalgamation within the national banking sector (Bank of Antigua into Eastern Caribbean Amalgamated Bank; ABI Bank into Eastern Caribbean Amalgamated Bank; and National Bank Anguilla and Caribbean Commercial Bank into National Commercial Bank of Anguilla), the ECCU is still overbanked; that is the region has more banks per capita compared with other countries within the Caribbean;
- g) Recent experiences with bank resolutions in the ECCU confirm that they are difficult, reputationally damaging and fiscally costly. The recent resolution of four national banks (Bank of Antigua, ABI Bank, Caribbean Commercial Bank and National Bank Anguilla) attests. A key lesson is that, as far as is possible, resolutions ought to be avoided; and
- h) During consultations held with the national banks in November 2017 and February 2018, the ECCB agreed to support the shared services initiative of the banks as an initial step towards further consolidation of the national banking sector.

3.0 BACKGROUND

In 2009, the Eastern Caribbean Central Bank Monetary Council (the Monetary Council) approved the ECCU Eight Point Stabilisation and Growth Programme (Eight Point Programme), which was framed in response to the economic and financial challenges that confronted the ECCU at that point in time, primarily as a consequence of the negative impact of the 2007/08 global financial and economic crisis.

Point Seven of the Eight Point Programme was one of three points framed to address financial stability in the ECCU financial system and is centered on the amalgamation of the national banking sector. During consultations held with the national banks in November 2017 and February 2018, the ECCB agreed to support the shared services initiative of the banks as an initial step towards amalgamation of the national banking sector.

The issue of consolidation of the national banking sector is important as the ECCB and the member governments cannot afford to continue to intervene in the commercial banking sector given the enormous fiscal and societal costs. The amalgamations that have taken place within the national banking sector, thus far, have been as a responsive measure under very difficult circumstances. Therefore, there is a need for a systematic and proactive approach to consolidation, which would serve as a key component in the broader strategy for ensuring the stability and resilience of the banking sector.

4.0 RATIONALE FOR CONSOLIDATION

During its 90th meeting held on 16 February 2018, the Monetary Council agreed on the important role of the national banks, particularly in the context of their social and economic contribution to the growth and development of the ECCU. The Monetary Council also considered the various challenges confronting the national banking sector and the need for exploring options for safeguarding the sector. Consequently, the Monetary Council approved a statement of intent and principles of bank consolidation for the ECCU national banking sector. (See Box I)

Box 1: INTENT AND PRINCIPLES OF BANK CONSOLIDATION

Intent of Bank Consolidation

The key objectives of promoting consolidation of the ECCU national banks are financial stability, and growth and development. It is envisaged that the ECCU will maintain an appropriate balance of national and international branch banks. In essence, national banks have performed and should continue to perform an important role in the ECCU.

Some of the national banks are, however, currently confronted with challenges of corporate governance, risk management, capital adequacy, compliance costs and de-risking, among others, which threaten the viability of these institutions and ultimately the stability of the broader financial system. Many of these challenges stem from or are exacerbated by the small, stand-alone structure of the national banks. Compared with the networked configuration that dominates in the international banking sector – which provides the requisite capital, technical support and economies of scale – the national banking sector is fragmented and often less efficient.

Box 1: INTENT AND PRINCIPLES OF BANK CONSOLIDATION

Given the social and economic contribution historically made by the ECCU national banking sector towards the growth and development of the region, it is a worthwhile objective to explore options for safeguarding the viability of this sector. Furthermore, as the ECCU develops the Single Financial Space, consolidation could better position national banks to take advantage of the expanded opportunities that the Single Financial Space may offer.

Principles of Bank Consolidation

Principle No.1

A strong national banking presence is critical to the development of the ECCU.

The national banks have performed and are expected to continue to perform an important role in the development of the ECCU economy, particularly through credit extension to productive sectors such as tourism, agriculture, construction and land development, and information and communication technology (ICT).

Principle No. 2

A strong banking system in the ECCU requires strong (well-capitalised and viable) national banks.

The presence of well-capitalised, efficiently-managed national banks will contribute to the proper diversification of the ECCU commercial banking sector, which is likely to foster competition that generates benefits for customers with respect to loan prices and quality of service. The national banks also facilitate financial inclusion, particularly with respect to small depositors, and offer broad geographic coverage in their provision of banking services.

Principle No. 3

Banks which are too big to fail or too small to succeed are risks to the financial system and should be avoided or minimised through effective regulation and consolidation.

On a worldwide basis and particularly subsequent to the global financial crisis, regulators of commercial banks are expected to apply regulation and supervision proportionately to ensure the reduction and eventual nonexistence of 'too big to fail' banks, which are considered systemic threats. The viability of 'too small to succeed' banks continues to be

Box 1: INTENT AND PRINCIPLES OF BANK CONSOLIDATION

threatened by escalating managerial and compliance costs, particularly those associated with anti-money laundering (AML), Countering the Finance of Terrorism (CFT), de-risking, Foreign Accounts Tax Compliance Act (FATCA), and Common Reporting Standards (CRS) and now International Financial Reporting Standards (IFRS) 9. Furthermore, 'too small to succeed' banks are considered threats to the banking system given the financial, reputational and social costs associated with the failure of small, nonviable banks.

Principle No. 4

Consolidation should be primarily industry-driven.

- 1) Consolidation of banks is primarily industry-driven and triggered by opportunities for: enhanced efficiencies in areas such as corporate governance and management, enterprise risk management, information technology, and audit;
- 2) increased market share; and
- 3) economies of scale regarding product development and services. Regulatory-driven consolidation may however occur in respect of a troubled institution and this would be based on the ECCB's assessment of the institution's condition and performance or in pre-emptive fashion given the global realities of the financial sector.

Principle No. 5

Where national banks are state-owned or have significant public ownership, Governments should play a proactive role in the process of consolidation.

Governments that have majority or significant ownership in national banks should utilise such positions to promote the consolidation of the national banks by divesting their significant ownership. This would send a positive signal to appropriate prospective investors and strategic partners. The national banks can benefit from the investments of strategic partners through: (1) capital infusion, and (2) expertise in corporate governance, strategic planning and technology. Such investments would certainly redound to the benefit of customers of the banks.

Box 1: INTENT AND PRINCIPLES OF BANK CONSOLIDATION

Principle No. 6

Bank resolutions are extremely costly and should be avoided.

Recent bank resolutions in the ECCU have been costly and time consuming and such situations could be preempted through consolidation. Every effort should be made to minimise the likelihood of further bank resolutions, given the significant costs associated with resolution of failed banks. Such costs include fiscal, regulatory, social, and reputational.

4.1 Overbanked Financial Space

The banking sector in the currency union consists of 20 licensed commercial banks. Of the 20 banks, 12 are national institutions and the others are regional and international banks. With a total population of approximately 630,000 people, the ECCU market is rather small. In recognition of the small market size, there have been amalgamation initiatives in the currency union. Notwithstanding these amalgamation initiatives within the regional and international banking sector over the past 15 years or so - for instance CIBC/Barclays Bank Plc and RBC/RBTT and the more recent consolidation of the national banking sector (Bank of Antigua into Eastern Caribbean Amalgamated Bank; ABI Bank into Eastern Caribbean Amalgamated Bank; and National Bank Anguilla and Caribbean Commercial Bank into National Commercial Bank of Anguilla), the ECCU is still considered to be overbanked. It is reported that “in comparison to other countries in CARICOM with similar bank concentration levels, the ECCU member countries have more banks per thousands of people than Barbados and Jamaica”.¹ As outlined in Figure 1, there is a high ratio of banks to the population in the currency union, compared with other countries in the region (see Box 2).

The continued restructuring of business operations by the respective regional and international banks, through the closure of branches, consolidation of back office and information technology functions, staff retrenchment and exploration of exit strategies, supports the assessment that the ECCU is overbanked.

¹ Consolidation: Reforming the Structure of the ECCU Financial System, *24th Annual Conference with Commercial Banks, 7 November 2016.*

The recent failure of four (Bank of Antigua, ABI Bank, Caribbean Commercial Bank and National Bank Anguilla) of the 14 national banks and the ongoing financial and operational challenges faced by the national banks indicate that the national banking sector requires consolidation to not only survive, but to thrive and provide the services and products the public requires and expects, at competitive prices.

Box 2: OVERBANKING IN THE ECCU

Figure 1: Comparative Sizes of Banking Sectors*



Sources: ECCB, World Bank, Central Bank of Barbados, Bank of Mauritius, Trinidad and Tobago Central Statistical Office, Central Bank of Trinidad and Tobago, Canadian Office of the Superintendent of Financial Institutions, Statistics Canada, Bank of Jamaica, Statistical Institute of Jamaica, Bank of Jamaica.
“Bank Building – dollar sign” by vokimon is licensed under Creative Commons Zero 1.0 Public Domain License. Retrieved from openclipart.org.

Figure 1 shows the relative sizes of the banking sectors in the ECCU together with its counterparts in the region. The figure also presents a comparison to the banking sectors of other countries of interest: Mauritius – a small island state – and Canada – a model of banking sector supervision. Relative banking sector size is measured as a ratio – the number of banks per 100,000 persons in the population. For the ECCU as a whole, the figure presents clear evidence of a high ratio of banks to the population, compared to its peers; that is, comparatively speaking, the ECCU region is “overbanked.”

There are over three (3) banks for every 100,000 persons in the ECCU. By comparison, Barbados – the country with the next largest relative banking sector size in Figure 1 – has only two and a half banks to service every 100,000 persons. The difference in relative banking size is sharper when the ECCU is compared with another regional peer – Jamaica. Compared with Jamaica’s relative banking sector size of 0.2 banks per 100,000, the ECCU’s relative banking size of 3.2 banks per 100,000 means that, relatively speaking, the ECCU’s banking sector is about 16 times as large as Jamaica’s.

*With the passage of the Banking Act 2015 there are now 20 licensed commercial banks in the ECCU.

4.2 Condition and Performance of the National Banking Sector

As at 31 March 2018 the national banks held the majority of the sector's deposit liabilities and that the quality of the loan portfolios was worse within the national banking sector compared with the regional and international banking sector. Also of note is that the national banking sector had an NPL ratio of 16.4 per cent contrasted with 7.8 per cent for the regional and international banking sector. (Table 1)

Table 1: Market Distribution of the ECCU Banking Sector as at 31 March 2018

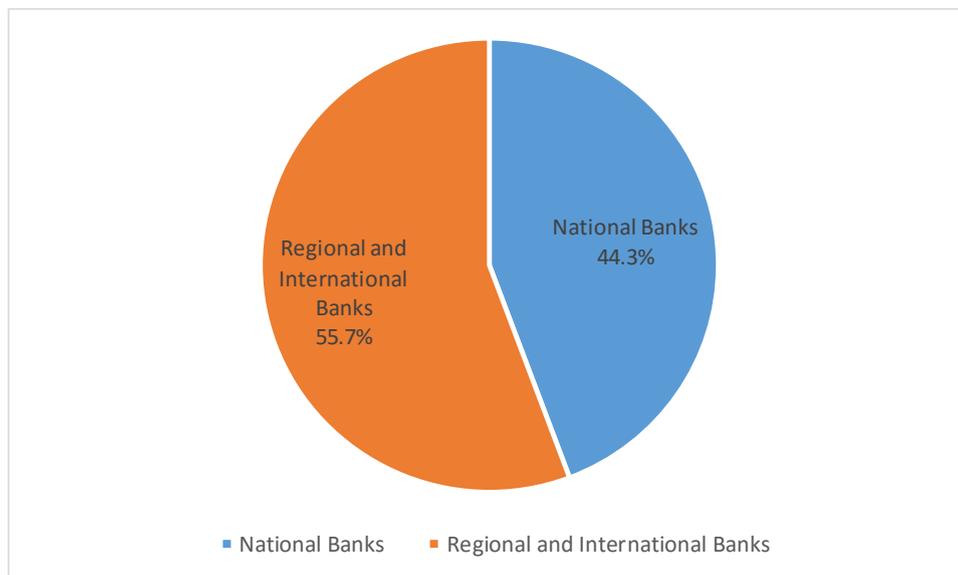
Name of Institution	Assets		Loans and Advances		Deposits		Non-Performing Loans Ratio (%)*
	EC\$m	Market Share (%)	EC\$m	Market Share (%)	EC\$m	Market Share (%)	
National Banks	13,647.8	44.3	5,603.1	45.9	11,333.9	52.5	16.4
Regional and International Banks	17,134.0	55.7	6,605.6	54.1	10,243.5	47.5	7.8
ECCU	30,781.8	100.0	12,208.7	100.0	21,577.4	100.0	11.7

Source: ECCB

*Non-Performing Loans to Total Loans

The majority of assets in the banking sector was being held by the regional and international banking sector. **Figure 2** shows that, as at the end of the first quarter of 2018, the regional and international banking sector accounted for 55.7 per cent of total assets in the ECCU banking sector.

Figure 2: Distribution of Assets Between Banking Groups as at 31 March 2018



Source: ECCB

Although the national banking sector includes a few large banks there are also a number of relatively small banks. The smallest three national banks together accounted for only 6.7 per cent of the national banking sector's assets and only 3.0 per cent of the assets of the entire ECCU commercial banking sector.

Operating within a small market has contributed to the challenges confronting the national banks. At present, the national banking sector is challenged with issues of capital adequacy; efficiency; profitability and returns on investment; risk management; corporate governance; correspondent relationships inter alia and continues to be exposed to the risks of economic and financial crises and natural disasters. Hence, the more consolidated the sector, the better prepared it would be to surmount such issues.

5.0 APPROACH TO CONSOLIDATION

With consideration for political and cultural issues, geographical locations, and likely synergies, the national commercial banks have considered shared services as an interim step towards more significant consolidation initiatives such as mergers and acquisitions.

5.1 Potential Benefits of Consolidation

The likely benefits of consolidation of the ECCU National Banking Sector include²:

- a) *Banking Sector Stability* – the stand-alone national institutions have been negatively impacted by the elements of the 2007/2008 global economic and financial crisis, poor corporate governance, lax risk management, increased competition from the international branch banks and credit unions. Four of these institutions had to be resolved in recent times and the remaining institutions continue to face challenges in their efforts to remain competitive. The resolution activities resulted in fiscal costs and it is likely that more fiscal costs will be incurred if the national banking sector is not amalgamated.
- b) *Greater Efficiency* – a consolidated national banking sector in the ECCU Single Financial Space will benefit from economies of scale and scope, and greater efficiencies in operations, which will likely translate into delivery of high quality banking services and products at reasonable costs in response to the increased competition from the international branch banks.
- c) *Enhanced Governance* – the board and management oversight of the sector could improve, given the consolidation of the available experience and skill sets, and could enhance the sector’s ability to treat with the implementation of Basel II, Basel III and IFRS 9, as well as addressing correspondent banking relationship issues.
- d) *Enhanced Regulation/Supervision* – the level of regulatory/supervisory focus will increase provided there is the emergence of stronger, more efficient and better governed/managed institutions.

These benefits point to the potential for improvements in efficiency and reduction in unit cost of financial intermediation through economies of scale and enhanced governance, with the potential for onward gains with respect to growth and economic development.

² These benefits would have been previously discussed in: Eastern Caribbean Central Bank. (2013). Consolidation: Reforming the structure of the ECCU financial system. *24th Annual Conference with Commercial Banks, November 7.*

5.2 Potential Challenges to Consolidation

The consolidation process may be challenged in several areas, including the following:

- a) Lack of full understanding of the dynamic operating environment by boards of directors, customers and the public.
- b) Possible reservations about consolidation due to issues such as staff retrenchment and the consequential socio-political impact.
- c) Inertia by boards and management of the respective banks.
- d) Reluctance by shareholders and the wider investing public.
- e) Valuation methodology and the determination of shareholder value.

The challenges underscore the importance of extensive outreach to all stakeholders (both public and private) and the need for commitment and support from the member governments to ensure the success of the amalgamation process.

Table 3 summarises the key benefits that are likely to accrue from the consolidation of the national banks and highlights some of the potential challenges to the consolidation process.

Table 3: Summary of the Benefits and Challenges of Consolidation

Benefits	Challenges
Reduction in unit cost	Reservations about consolidation
Greater efficiency in financial intermediation	Inertia by boards and management of banks
Enhanced governance	Lack of support by shareholders and the wider public
Enhanced and more focused supervision as there are fewer entities	Valuation methodology and the determination of shareholder value
Increased financial sector stability	

6.0 ROLE OF MEMBER GOVERNMENTS

Member governments are expected to play a proactive and supportive role in the consolidation process. An essential pre-requisite to consolidation of the national banking sector is the restructuring of the respective institutions to ensure financial and operational worthiness. The Eastern Caribbean Asset Management Corporation (ECAMC) and other private operators are expected to play a role in assisting with the national banks' disposal

of non-performing loans and, as such, the member governments' continued support of the ECAMC is important.

One of the goals of a financial institution is to attract additional capital toward balance sheet growth and provision of top quality service and products. The role of member governments in sensitising the public to the importance of the consolidation process in respect of the ECCU's future economic and financial development is equally important in the process.

7.0 COMMUNICATION STRATEGY

The success of the consolidation initiative would require the support of not only member governments, but also a broad range of stakeholders within the commercial banking sector. As such, it is recommended that a communication strategy be included as an integral part of the broader consolidation initiative. The communication strategy should target those stakeholders who operate within the commercial banking sector as well as those who interact with the sector in one capacity or another, namely:

- a) The boards of directors of the commercial banks;
- b) The management of the commercial banks;
- c) Shareholders of the commercial banks; and
- d) The public.

The communication strategy should include, inter alia, a public education campaign that outlines, for each group of stakeholders, the practical implications of consolidation. It would also be important to engage with the groups to ascertain their main concerns about consolidation process in order to address any misinformation and allay any fears that they may have about how the process may impact their interests.

8.0 CONCLUSION

The consolidation of the ECCU's national banking sector remains an imperative for the ECCU if it is to have a strong and resilient financial system from which economic growth and development can be pursued vigorously. Key stakeholders must be engaged to ensure a timely and successful consolidation of the national banking sector.

Please send your feedback on the Consultative Paper on Consolidation of the National Banking Sector in the ECCU to: info@eccb-centralbank.org or to:

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