

Emerging Issues on the Horizon: Financial Services Industry in Trinidad and Tobago

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Abstract

Confucius' wish for his enemies to live in interesting times would have been different now given the gale-force winds of change blowing furiously through the financial services sector in recent years, moving the industry in challenging new directions. Similar to the case of the Titanic ship, what is visible is just the tip of the iceberg since the transformation of the industry is far from complete, and many players remain unprepared for the rigors of open competition. The liberalisation of the financial sector will become the battleground on which the struggle for new and existing customers will be fought. These cross currents are going to reshape the financial services sector, increase effective competition, empower consumers, encourage more flexibility and urge measures to improve the regulatory system. Such measures will increase customer value and set in motion dramatic changes in the structure and business paradigm of the industry. Even as this occurs, however, it is critical to acknowledge the fact that the gale force winds of global financial pressures today complicates the emerging issues on the horizon for the financial service sector. In the context of globalization and the interconnectivity of world markets, the local financial services industry undoubtedly is being and will continue to be affected by global pressures that are taking place currently and those that are still to come. The aim of this paper, therefore, is to provide an understanding of the major changes affecting the financial services sector especially as it pertains to the banking industry. The forces of change such as globalisation, technology, demography and changing consumer preferences and their implications are discussed. A synopsis of the challenges and opportunities which includes treasury management techniques, use of the value added concept and protection of shareholder value will be examined. In addition, global developments today and its impact and challenges for the local financial services industry will also be considered. Suggestions for the way forward will also be made. The paper concludes by challenging the industry's stakeholders to manage the relentless myriad of existing and forthcoming changes, in a way that best serves the collective interest of Trinidad and Tobago. From the literature reviewed, it would seem that the financial services sector is moving the industry in challenging new directions. It is being fuelled by the liberalization of the financial sector and the current financial crisis. Arising out of this, there would be challenges and opportunities as this sector will continue to be affected by global pressures as it impacts on the local financial sector.

Keywords: financial services sector; globalization; financial crisis; liberalization; demography; challenges and opportunities; ethics and CSR; Caricom currency; and gender.

Introduction

Trinidad and Tobago's services sector has taken on growing importance in the development of the economy. Today, it accounts for 60% of Gross Domestic Product (GDP) and 75% of total employment.

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With Valuable Assistance from: Ravi Ramdath; Riann Singh; Dionne Hanson; Cherry Buckmire; Miguel Martinez

Within this sector are the financial services, which have experienced major transformation and now accounts for 11.5% of GDP earned. This twin island has set its sights on becoming the financial and services hub of the Americas – at least, in the first instance. The country's services sector has taken on growing importance in the development of the economy (TTSE¹ 2011 Report).

The country can now boast that it has eight well-established commercial banks (six of which are foreign-owned), a unit trust and several mutual funds, mortgage finance companies, trust and pension fund managers, life and general insurance companies, development finance institutions, credit unions, venture capital companies and other non-bank financial institutions. The three largest banks account for 70% of total bank assets and the three largest insurance companies account for 75% of the insurance industry with the largest one, Colonial Life Insurance Company (CLICO) accounting for almost 55% of total insurance assets (Ewart Williams²). These institutions, apart from competing in the development of new and improved products and services tailored to the needs of the customers in the financial market, supply liquidity that makes the industry an important engine of the country's economic growth (Alleyne 2000, Alfaro *et al* 2004).

Within recent times, mutual funds have been a good example of products that have been growing rapidly on account of improved and advanced technology and better returns (Klapper *et al* 2003, Tanzer 2007). These funds support the listed institutions whereby those with a need to raise capital, mostly entrepreneurs, can interface with those that have the capital resources to invest on reasonably equitable terms in the local stock exchange. This exchange has added so much value that it has been rated in 1998 as the fifth fastest growing in the world (Alleyne 2000, Bang 2010).

Lately, there are radical changes that are driving and affecting the financial services industry in Trinidad and Tobago, especially in the area of banking. According to Boylan (2000, cited by Fanning) conventional retail banks will not be able to fend off the threat from Internet banking, particularly from what he calls “the cyberbanks”. Today's customers are more informed and demand more than ever before, as they look for the best value and for increased choice, control and convenience in how they access financial services (Majumder 2005). This trend will continue as tomorrow's consumers obtain even more sophisticated networking tools that will offer more options for exercising their growing power in the marketplace. The challenges and opportunities presented by the rapidly changing financial service sector are forcing institutions to closely examine their electronic offerings and to continually evaluate and invest in new applications and infrastructure in an effort to offer highly reliable and value-added services that customers demand. At the same time while being customer-centric, banks and non-banking institutions must also devise strategies that comply with local and international regulations to avoid being scrutinized by regulatory bodies (Ramnawaz 2001, Pasiouras 2008).

The current global financial crisis and the incumbent regulatory and monetary changes further complicate the challenges and opportunities for the local financial services industry. The fact is that global undercurrents within the financial services sector can potentially devastate the finance sector and world economies. Such potential impacts are already visibly taking place in countries around the world. In Europe, the current Euro situation is challenged by the Greek debt crisis and it may become worse when Venezuela decides to move the \$11 billion gold reserves from the US and UK. In fact, “the 17 countries that use the Euro need to build a US\$1.3 trillion firewall to help the struggling currency union return to growth”. The onus is therefore on the stakeholders within the industry to manage the changes and challenges that are underway and that are yet to come. (Economic Times News 2012; Angel Gurría, Head of the Organization for Economic Cooperation and Development. March 28, 2012 Express Newspaper p. 48)

Radical Changes

Money and banking over the last twenty years have become more and more a virtual experience. In addition to cash, banking has evolved to credit cards, automatic banking machines, debit cards, telebanking, smart card (electronic purse) and more recently, internet banking (fresh new e-possibilities). Many financial transactions can be undertaken by digital means without the need for actual cash to change hands, just imagine what our grandparents missed.

¹ TTSE- Trinidad and Tobago Stock Exchange Limited (2011)

² Central Bank Governor, Address to South Trinidad Chamber of Commerce, April 6, 2009

In today's world, it is difficult to manage financial transactions without the use of *plastic* (Burke 2002). Changes are taking place as institutions market their services over the Internet. Failure to meet customers' needs leads to the demise of that institution as dissatisfied customers immediately switch to the competitor. Web sites that offer one-stop resource centres providing convenient, anytime access to continually updated information on products, interest rates and online applications, as well as a range of interactive tools can help customers make better financial decisions. Modern customers demand speed, convenience, off-site cash access, lower fees or no fees at all and a wide variety of banking operations (Minjoon and Cai 2001).

Local Banks have become more aggressive and have embarked on a regional and an international marketing strategy. Over the last ten years, Trinidad and Tobago banks have floated bonds not only for the domestic setting but also to assist regional governments in raising much needed capital for investment purposes. Many are forging alliances and are developing a strong presence with subsidiaries in Grenada, the Cayman Islands, Guyana, St. Maarten, Jamaica, Suriname, Curacao and St. Vincent among others. It must be noted that Republic Finance and Merchant Bank Limited (Fincor) financed projects in Grenada, St. Lucia, and St Kitts. Currently there is a proposed financial arrangement to fund an Eastern Caribbean Gas Pipeline project from Trinidad to Barbados, and an ethanol plant in Guyana (Caribbean 360 News 2012).

Another recent development within the regional banking sector is that of consolidation for survival of the fittest. This signals the direction in which the Caribbean's business sector should be focussing. Smaller indigenous banks have been acquired by and/or merged with larger banks to create meaningful and stronger financial institutions which is intended to build/fortify the financial pillars of a new economic era in which the Caricom Single Market and Economy and the Free Trade Area of the Americas will be in operations. Such mergers and acquisitions include First Caribbean International Bank and Barclays PLC, The Mutual Bank of the Caribbean and the Bank of Butterfield of Bermuda and the Caribbean Commercial Bank and the more recently, RBC Holdings Limited and RBTT Limited. Whilst such a development may create a vacuum for smaller, more personable savings and loans operations, the credit union movement is well poised to benefit (Hoyos, 2004).

On another front the market is heating up with increased trading in equity and mutual funds investments as well as an increase in foreign investments by local businessmen. All these changes have been fostered and nurtured by a number of forces namely globalisation, advancement in technology, demography and changing consumer preferences moving the industry in challenging new directions.

1. Globalisation

Globalisation affects the way we live and interact. It influences government policies, the environment, economies and international relations. It is a powerful force for market integration, where distances are shortened and valuable information travels across the globe like never before and where commerce, technology and trade act as the forces that gradually shrink our world into one global village. E-commerce and the Internet are undoubtedly the backbone of globalisation and businesses going forward. This increase in technology and trade purported by the Internet has challenged leaders of developing countries to liberalise their economies to foster trade and overall productivity (Wymbs 2000).

Following international trends, the economy of Trinidad and Tobago was liberalised over the period 1991-1993. Attempts at de-regulation included the removal of the "black list" which allowed for the importation and selling of foreign products on the local market. This proved to be a major challenge for local firms as competition intensified at all levels. To add fuel to the fire, the flotation of the Trinidad and Tobago dollar in 1993 allowed banks to increase the services provided to their customers by providing facilities far beyond its borders. Customers were allowed to hold dual interest bearing accounts and do transfers without restrictions. Residents in Trinidad and Tobago were able to by-pass the local finance industry and invest their funds through foreign brokerage firms with a larger investment portfolio from which to choose. This was a clear signal that if knowledgeable investors were purchasing international stocks to achieve a greater potential return and broader investment diversification, then the local finance industry must have responded by honing their products if they were to remain competitive and even survive.

The Unit Trust Corporation (UTC) is a progressive and an active investment centre that has established operations in the United States of America to access the best deals available by selling its products at a price comparable to its foreign counterparts. This has encouraged participants in the local industry to improve the delivery of financial products in order to be more competitive with the rest of the world. According to Gorbet (1999) there has truly been much financial and economic integration over the past decade. Capital markets are becoming global and have transformed the way financial services are provided. Today, large companies can search the world to get the best deals (BIS³ Review 2008).

Globalisation will not abate. Indeed, the push is for development of global enterprises to supply retail financial services. Citibank and American Express have global brands. Niche players like MBNA are building retail businesses and is growing by 28% per year in an industry that is growing by 6% a year. It offers more than 4,500 affinity credit cards and is active in several countries. These players are extremely successful in their market places. How much more successful they will be globally, and in what time frame are still unanswered questions. But there is no question about where they are moving, knowing that the movement is being facilitated by the increasing use of the Internet and electronic commerce (Gorbet 1999, Wymbs 2000, Berger *et al* 2003).

2. Technology

The revolution in technology, information, and communications has affected people's way of life. Without exception, the world's leading businesses are using technologies to find ways to create and deliver value in more efficient ways to grow their operations. The financial services industry is among the best places to exploit the advances in technology. This is because its products are services, which are essentially intangible and do not need to be physically delivered to customers (Adriaenssens, 2000). Apart from the maximisation function, technology-driven gains in productivity and cost efficiency have begun to transform a hierarchical, regulated and labor-intensive industry. To appreciate the impact of technology on the financial services sector, consider this: the computer revolution is truly and radically changing the ability to access, filter, understand and respond to real-time information. So much information has never been so widely and immediately available now that technology is making it easier for new financial service players, both domestic and foreign, to target customers. The Y2K fiasco has had a tremendous impact on computer technology globally. It has revolutionised the financial institutions as billions of dollars were spent to install state-of-the-art systems, with the purpose of enhancing future compliance (Kolodinsky *et al* 2004, Wymbs 2000).

Technological advancement is not only revolutionising the way we do business but also the way in which customers view financial institutions (Zhu *et al* 2004). Technology facilitates consumers' demand, tracks their preferences and documents their interactions, which enables such information to be used to provide better products and services. "Advances in computing power have placed at customers' fingertips financial know-how and have allowed the adoption of innovations in the theory of finance that is transforming our ability to assess and manage risk. From derivatives to asset securitization, technology and innovative techniques are moving forward together to revolutionise the financial services industry" (Gorbet, 1999, p.23). Indeed, technological innovation and its applications to the financial services industry never end.

"The banking industry in Trinidad and Tobago is one of the more efficient industries due to its enormous investment in technology for the purpose of keeping abreast of international developments" (Young, 1999, p.15). Local banks such as First Citizens Bank (FCB), Scotia Bank, Republic Bank and Royal Bank of Canada (RBC) are now offering Internet and mobile banking services to its customers. With the exception of depositing or withdrawing cash, advancement in technological know-how and do-it-yourself banking facilitates businesses to be conducted online. Bills can be paid and account balances checked whether it be at home or at branches where kiosks (computers placed in the lobby area at specific branches) are available for use by customers. As the pace of technological innovation continues to accelerate, technology is becoming cheaper, faster and better. "However, while the cost of doing transactions via the internet and other similar electronic devices are falling globally, they are not falling at the same rate in Trinidad and Tobago" (Dookeran, 2002, p. 10).

³ BIS- Bank for International Settlements

To keep abreast with the developments in technology and changing consumer needs, banks are ensuring that online transactions are conducted in a safe and secure manner. For example the gateway system uses 128-bit Secure Socket Layer (SSL) channel encryption to prevent message tampering while users are transmitting information over the Internet. In laymen's term, this ensures that all credit card transactions/information are relayed in the most secure manner to prevent any possible "reading" of credit card information (SCOTIA e-NEWS, 2001, Scotia Bank Website⁴ 2012). However, the sophistication of the perpetrators supported by reasonably priced cutting-edge technology create new challenges daily. Therefore, initiatives must continuously be designed so as to control or reduce the amount of fraud in the system.

Finally, security audits are an essential part of any financial system. Although the task requires the maintenance of an internal audit department, the audits are a good way to keep the Information Technology department abreast of security concerns. Internal audits are very beneficial, in that they provide necessary checks and balances but they also require the use of an annual independent third party. These third parties can be quite expensive and often have narrow consulting skills. Finding a party that can meet the firm's needs at an affordable price can be a challenging task. Indeed such parties will have access to key confidential company information and thus new laws have to be developed locally to protect companies from abuse of sensitive information (Colman, 2002). For electronic banking to be attractive to consumers and businesses, it should not only save money, but also provide trust and confidence to its users (Kolodinsky *et al* 2004). This can only be ensured over time (Heeralal, 2001). "Banking, undoubtedly, will continue to undergo radical changes - but clicks need bricks. People still want personal contact, even if less frequent"(Maharaj, 2001.p. 2). While technology and globalisation are leading to new ways of doing things, demography is changing the focus of what is being done in retail financial services.

3. Demography

Research reveals that wealth management type products are gaining acceptance on the local market. According to Gorbet (1999) money market mutual funds and life insurance companies are preparing to offer the convenience of cheques and debit cards in order to capture some of the transactions market that has to date been the preserve of deposit-taking institutions. Customers are no longer accepting the guaranteed rate that savings accounts offer but are seeking to maximize their returns by investing in riskier and higher yielding alternatives such as equities.

It is believed that banks will exit many product lines as value migrates or they may be forced to develop hybrid products, which may allow customers a diversified investment portfolio, and this may also include an insurance element, for which the customer will pay a premium (Young, 1999). An increasing evolution of banks from financial service producers to financial service brokers will occur- leveraging the considerable equity in their own brands to become trusted distributors of best of breed products, including, but not limited to, their own. Banks will increasingly integrate their operations and emphasis will be placed on wealth management in years ahead as this is the prize financial institutions are focused on. It is an important factor in the convergence of institutional function that has taken place and is continuing.

Markets would be looked at rather than institutions. The retail marketplace is likely to become more crowded, competition for deposits will continue to squeeze margins, consumers will benefit from increased competition and financial institutions once successful will have to be more focused, more agile and more consumer-centered than ever before. Finally, with the introduction of the Euro and the potential removal of the Venezuelan reserves, there are wealth management implications for local financial institutions that currently have investments in European currencies. Accounting adjustments will have to be made given the buying and selling of goods and services in Euros, the preparing of financial statements using the Euro as well as determining an acceptable exchange value for the currency. Although the above macro issues are of significant importance, the radical change in consumer patterns cannot be ignored.

4. Changing Consumer Preferences

Institutions are reacting to changing consumer preferences by establishing and maintaining long-term relationships with customers. Banks in particular are in a race to become increasingly more consumer-centric and with the advent of technology, the vision is to deliver low-cost, high quality, hassle-free-products through customer friendly and feature-rich channels that are consistent across delivery methods.

⁴ Scotia Bank Website Article on SSL; accessed on 24th April 2012 from the website: <http://www.scotiabank.com/ca/en/0,,1210,00.html>

Consumers today are much different from those of a decade ago. They are more involved, more knowledgeable, more aware of financial product characteristics and provider choices as consumers have been empowered through information and technology. Consumers are comfortable with new technologies such as Internet investment sites, online trading and online message boards devoted to investment information, have been using them and are making continuous demands on service providers.

Banks are fully aware of this development and are taking greater control of the customer relationship. Instead of focusing on distribution channels, today banks emphasize access points. The difference is significant as there is no longer a need for a physical market place where institutions distribute products to consumers. According to Gorbet (1999), consumers are now choosing to access institutions through the Internet and conduct financial transactions on the banks' Websites. Also it is now possible, through the use of "aggregators" on the Internet, to examine the offerings of many providers on one site (Kolodinsky *et al* 2004, Wymbbs 2000). Trinbagonians now appear to have greater risk tolerance as over the years they have built up their confidence level, particularly as it relates to corporate governance issues and to other business activities. Confidence is an important element in the chemistry of business and implies many positive things, among them trust, reliance, assurance and belief. This is highlighted by the tremendous growth of equity trading. The opportunity to enjoy better returns has also fuelled the growth of the money market and mutual fund industry. Equities and mutual funds account for a significant percentage of the average household financial balance sheet.

As reported, the total funds under management in the mutual fund industry in Trinidad and Tobago showed remarkable growth between 1994 and 2001. In 2001, the funds stood at TT\$9,095.9 million, compared to TT\$841.3 million in 1994, representing an average annual growth rate of 122.5% over the period. The entrance of new and different type of mutual funds together with relatively high rates of returns in the sector contributed to this strong growth record (Ministry of Finance Green Paper, 2003). In a more recent report, according to the Central Bank of Trinidad and Tobago Report (July 2011); following subdued performance in 2010, there has been some pick-up in growth in mutual funds under management. Mutual funds under management rose by 1.8% to \$36.3 billion at the end of June 2011 from \$35.6 billion at the end of December 2010. Investor appetite for mutual funds seems to be returning, as the industry recorded net sales of \$146.9 million during the first half of the year (2011).

The shifting of risk from institutions to consumers now has important implications for industry structure as articulated in the following two examples:

- (i) Over the past two decades, mutual funds held by Trinidadian households have been experiencing explosive growth. Today Trinidadian households hold more money in mutual funds than they do in bank deposits, which have been declining since the mid-1990's. According to Singh (2001) money market mutual funds increased by 218 % over the period 1997 to 1999 and for the first half of 2000 increased by 75 % over the corresponding period in 1999. In a recent Central Bank Report (2011), money market mutual funds increased to \$36.3 billion at the end of June 2011. The attractiveness of mutual funds over deposits could be attributed to yields, expertise, diversification and convenience, notwithstanding that Deposit Insurance Fund⁵ insures deposits up to \$125,000. (Deposit Insurance Corporation Trinidad and Tobago).
- (ii) We have seen tremendous advances in payments technology. Cash, cheques and credit cards are fast giving way to the debit card. As of January 1, 2001 commercial banks stopped issuing guarantee cheques as The Bankers Association in Trinidad and Tobago believes that the electronic nature of the debit card will reduce the loss to all stakeholders due to the use of a more secure pin code. When a debit card is used, both the merchant's and the client's accounts are almost instantly affected. This helps to eliminate the float that exists when either a cheque or credit card is tendered, both of which require signature authorisations (Pereira, 2001). The credit card however remains as a popular form of payment. A study carried out by Republic Bank Limited stated that there are more than 130,000 active credit cards in Trinidad and Tobago with a usage of over \$2 billion dollars. Very shortly Trinidad may well follow Japan where extensive use of banking is conducted through i-mode given the Japanese penchant for avoiding hand written cheques.

⁵ Pursuant to Legal Notice No. 10 of 2012, the deposit insurance coverage limit has been increased from \$75,000 to \$125,000 per depositor in each capacity and right in each member institution licensed under the Financial Institutions Act 2008

Challenges and Opportunities

Financial institutions will increasingly come under pressure as competition continues to intensify brought on by trade liberalization, external currency crisis (Euro) and as countries move their reserves from democratic countries to socialist countries (Express Newspaper March 28th 2012). Improvements in information technology will contribute to increase competition, and already some foreign-service providers are selling financial services to Trinidad and Tobago via the Internet. However, liberalisation of financial markets will create opportunities for local providers who already have a competitive advantage regionally, especially in the areas of banking, insurance and mutual funds to export services to other CARICOM states. More open markets in the domestic environment are also expected to benefit the consumer through access to a broader range of products at more economical rates (Ministry Of Finance Green Paper, 2003). Retail financial services will be the battleground on which a lot of institutional positioning will be played out and banks will have to shape up because that is where the money will be. The margins on international business will continue to shrink and Return on Equity (ROE) that has replaced growth in premiums or assets as a performance measure in wholesale financial services have been trending down for a decade now as globalization has further intensified competition. It is precisely in the area of personal financial services, however, where new competitors offer the greatest threats and this activity must be pursued aggressively as this is a major profit source.

According to Chambers (2012), problems relating to the fiscal and trade balances of the developed world (key economic issues of the larger crisis) are so titanic that piecemeal solutions seem unlikely. The financial crisis is currently rolling into its sixth year and it is far from the end. Not until the developed world gets its trade and fiscal budgets back in line will it be over; this is a long way off. This outcome is not in the hands of markets which automatically rebalance; instead it is in the hands of governments which have slowed and stifled an economic correction. If governments of the developed world do not move to bring the economies into balance at some point, markets and economies will seize up (Greece and to a less extent Ireland, Portugal, Iceland). To get the world out of financial 'intensive care' and back to reality something new has to happen. It seems democracy is reaching out for something new, perhaps dangerous and risk laden from the political realm rather than suffer the interminable agonies of the known; this course of action normally does not end well. Key to these challenges is critical given the current climate on how these businesses address business ethics, corporate social responsibility and compliance.

Business Ethics, Corporate Social Responsibility and Compliance

Local financial service companies need to elevate their participation in the global ethics and corporate social responsibility (CSR) movements. At present, the websites of many local and regional firms do little beyond describing various community outreaches in their CSR reporting. By contrast, some of the financial companies in the world such as JP Morgan Chase, Santander and Mitsubishi UFJ Financial Group Inc. provide extensive CSR reporting, detailing topics such as sustainability in operations with extensive descriptions of their achievements on such points as reducing carbon emissions, paper use and energy consumption; green finance and diversity in their workforces. These firms also typically make reference to globally accepted principles and reporting guidelines including the Global Reporting Initiative (GRI)⁶ and the Equator Principles⁷. Hohnen (2008/2009) refers to a study by Vigeo, a European agency that assesses and rates CSR performance. The study shows that most of the largest publicly-listed European companies base their CSR approach on guidelines and instruments provided by the UN Global Compact⁸, the ILO Tripartite Declaration⁹ and the OECD¹⁰ MNE Guidelines which were all endorsed by the G8 summit of 2007.¹¹

⁶ GRI is a multi-stakeholder governed institution providing global standards for sustainability reporting

⁷ The Equator Principles a global private sector initiative to provide guidance for managing social and environmental risks in project financing.

⁸ UN Global Compact – a strategic policy initiative of the United Nations for businesses that are committed to aligning their operations with universally accepted corporate responsibility principles

⁹ The ILO Tripartite Declaration is a declaration of principles put forward by the ILO (International Labor Organization) to guide the operations of multinationals as well as governments and employers' and workers' organizations. It covers issues such as non-discrimination, employment security, training, working conditions and freedom of association.

¹⁰ OECD - a coalition of governments aiming to promote economic growth and sustainable development in the world

¹¹ The G8 (short for Group of Eight) is a forum for governments of eight nations of the northern hemisphere which represent the world's major industrialized democracies. The forum's major meeting is an annual summit in which participants discuss issues of mutual or global concern.

Most of the companies studied reported using more than one instrument and most companies referenced these internationally recognized guidance instruments in their annual CSR or sustainability reports. Industry leaders use global guidelines together with marketing principles to develop CSR website reports that resonate most effectively with their audiences. Local and regional firms benchmark their own practices with a view to achieving the highest standards in the industry and poising themselves for competitive advantage. This is of particular importance as multinationals are increasingly using CSR practices in their supplier evaluations. Similarly, a firm could easily be black-listed if it fails to follow globally recognized guidelines. Generally, CSR initiatives have a positive influence on consumer preference (Brown and Dacin, 1997; del Mar Garcia de los Salmones et. al, 2005) investors (Orlitzky & Rynes, 2003) and potential employees (Backhaus et. al, 2002). Notwithstanding ethics and CSR practices, the global financial crisis and its impact on the local financial sector do not discriminate.

Global Financial Crisis and Its Impact on the Local Financial Sector

The challenges and opportunities associated with the radical changes underway and on the horizon for the financial services industry, however, are now being complicated by what is termed ‘the global financial crisis’. As financial innovation and the continuous creation of new financial products sweep world financial markets, crisis struck and continues to strike even the strongest economies of the most developed countries. These occurrences happen at a pace much more rapid than the creation of financial regulation and legislation, given the context of global recessionary pressures, which have been brewing for a while and have started to show its effects from 2007.

Around the world, large financial institutions have collapsed or been bought out, stock markets have fallen and governments in even the wealthiest nations have had to come up with rescue packages to bail out their financial systems. On the one hand, many people are concerned that those responsible for the financial problems are the ones being bailed out, while on the other hand, the global financial meltdown has affected the livelihoods of almost everyone in an increasingly inter-connected world. In this context of interconnectivity and globalization, the financial services industry in Trinidad and Tobago is being affected and will continue to be affected to a significant extent. The effects of the financial meltdown on a global scale are starkly visible in all aspects of the local financial service sector from the wavering confidence in the banking system for example, to the ‘bail out’ of the largest financial organizations. It is quite clear that the current global financial crisis can be likened to a global hurricane whose tidal waves portend to serious damages to Trinidad and Tobago and by extension the Caribbean unless countervailing actions for mitigation and adaptation are undertaken (Greene, 2009).

The fact is that the world has changed and is in a continuous state of dynamism. According to Greenspan (former Federal Reserve chairman), “*in a free market economy there are bubbles all the time*”. While some countries were able to rise to the occasion and treat with the bubbling effect, in our local context, CL Financial became a victim of the global economic collapse (Business Express, February 04, 2009). This is not just a problem for Trinidad and Tobago investors but by extension, it affects other countries where CL Financial does business. In this regard, the Government of Trinidad and Tobago and other governments in the Caribbean came to the rescue of CL financial investors.

Nevertheless, the question of how much pressure local financial institutions can withstand in the face of the shrapnel from the global financial crisis remains an issue of concern. It has already been demonstrated that ‘bailout packages’ cannot realistically be extended to every financial institution that ‘stands on shaky grounds’ (Business Express, February 25, 2009). Similarly, it has been made clear that there is an urgent need for the adoption of good governance practices, law enforcement and swift justice (Sabga 2012). Despite the expected ‘crisis of confidence’ among investors and depositors, the Bankers Association of Trinidad and Tobago (BATT), reiterates that the local banking sector still remains strong. As published in Business Express (February 11, 2009), all their member banks give strong asserting assurances that customers’ deposits and investments are secure and well-managed. Excluding Clico Investment Bank (CIB), the local banking system boasted an average capital adequacy of 18%, compared with a recommended minimum of 8% (Governor of the Central Bank, Ewart Williams, February 2009). The Caricom Financial Services Agreement (FSA) should be seriously considered so that financial entities will not be able to escape regulations in one regional jurisdiction by exploiting legal loopholes in another.

Girvan (2009) stresses that a seamless regulatory environment for financial services and investments across the national and regional space will serve to strengthen the effectiveness of regulations aimed at averting another 'Clico-like' debacle and heighten the attractiveness of this country as an investment and financial destination.

As the struggle within the financial services industry continues, there are a number of other contextual issues which must be addressed. These issues that are relevant to the stability of the financial services industry within Trinidad and Tobago, are as follows.

1. Avoid Political Instability

Unsettled political situations can have a material and powerful impact on business activity and investment climate. For example, fortunately for Trinidad during the standoff stage, foreign exchange reserves increased as investors adopted a wait and see attitude to the then political 'deadlock' situation. Normally, when investors lose confidence in a country they usually repatriate their funds and more recently, business confidence was questioned during the 'State of Emergency' declared by the People's Partnership Government. In this regard, a stable government, implementing sound policies, can have a powerful and beneficial impact on all investors, both local and foreign (Pereira, 2001).

2. Vary the Reserve Requirement

Varying the reserve requirement for banks to gain political mileage can have a material effect on the economy. For example, efforts of the Central Bank of Trinidad and Tobago in 1997 to reduce the reserve requirement by two percentage points backfired and the bank had to quickly increase the reserve by three percentage points within weeks. The decline in interest rates caused by this reduction in reserve requirement failed to yield the desired benefits and made it unattractive for investors to keep their money invested in TT dollars (Ramesh, 2001). Again in May of 2001, the Central Bank reduced the statutory reserve requirement from 21 % to 18% which triggered a 1% reduction in the lending rate of US\$ and Commercial Bank short-term deposit rates increased 2% moving from 7.75% to 9.75% on average. This time around, the reserve reduction miracle did work as the mixture of monetary and fiscal policies had a positive impact on local economic conditions. A planned strategy to mop up the excess liquidity through the issue of fixed rate government securities should be devised before embarking on any initiative to reduce the reserve requirement. Open Market Operations (OMO) infrastructure should be strengthened before undertaking such a move (Ramesh, 2001).

3. Introduce a Common Currency

The financial industry should lobby all CARICOM countries to work towards sharing a new common currency probably calling it the CARICOM dollar. This arrangement of a single currency represents another step toward creating a single market and fostering greater co-ordination of economic and monetary policies. The CARICOM dollar will enhance stability, predictability, comparability, provide a simplified foreign currency conversion and transparency throughout the region. At the same time, it will encourage greater competition among companies in the region bringing more choices and opportunities, as companies will be made stronger and more competitive by:

- The disappearance of exchange-rate risk
- Increased competition in the banking industry and lower interest rates
- Companies will be able to sell their products and services across a far wider area to more potential customers.

4. Use Treasury Management Techniques

More emphasis should be placed on treasury management techniques due to the increasing pressures on profit margins in the competitive financial service environment. Engaging in more securitization should be looked at, since it is a practice that is proliferating financial markets in developed countries, and is currently being done by local institutions to some extent. Securitization involves selling financial assets to trusts. This mechanism releases capital to be re-deployed to alternative revenue-generating purposes as it enables a reduction or eliminates the need to hold capital against higher risk-weighted assets. It serves as an effective balance sheet management tool as well as an effective liquidity management instrument (Young, 1999).

5. Encourage the greater use of Derivatives

Another powerful mechanism is to create derivatives based on the value of a wide variety of investment products. In Trinidad and Tobago, the derivative market is barely past conception.

However, Accountants and Investment advisors confirm that some of our larger corporations do invest in derivatives but on the international market (Brasnell 2002). Derivatives can be used to hedge against future price changes and/or delivery uncertainties. They can be used as an effective risk mitigation instrument rather than a risk-enhancing instrument. Transactions are structured so that losses from one type of result are offset from the gains on another type of outcome. Several factors contributed and influenced the growth in the use of derivatives. These are globalisation of the capital markets, deregulation, and interest rate volatility and tax avoidance.

Derivatives are likely to become an increasingly larger part of the financial landscape and can be an effective defensive business tool once properly used. However, its usage challenges our abilities to meaningfully analyse the intrinsic values and real risks reported in financial statements. However, Pereira (2000) called for vigilance as man's ingenuity to invent new forms of derivatives far out paces any regulator's ability, to monitor or anticipate the possibilities for abuses or misrepresentations. Navigating these ongoing dynamic changes in servicing these instruments will no doubt continue to be a challenge in the operations of the financial services industry.

6. Use of the Added Value Concept

According to Young (1999), given the intense competition in the industry, both from banks and non-banks, the concept of added value will play an important part in future bank/customer relationships. Customers will expect a lot more from banks than they have received in the past. For example, financial planning and advice will become a standard service. The average banker will have to be a financial counselor in areas such as mutual funds and investments, long term savings and mortgages. If these services are not provided, banks would have trouble keeping their customers. Tomorrow's winners have to be focused on the customer, as this is the only way to survive. You simply can't succeed any other way.

7. Protection of Shareholder Value

Banks must continue to move to protect shareholder value. They must also seek to reduce costs, manage channels more aggressively, economise on capital and expand through acquisition and alliance in ways that compliment their strategic direction. Over the next five to ten years major banks will probably become more differentiated in their domestic operations, as they have become differentiated internationally over the past decade (Gorbet, 1999). In the United Kingdom situation high street banks claimed that they made significant advances in the development of 'no frills' accounts suitable for customers on low incomes or in receipt of social security benefits (Fanning, 2000). These contextual issues impact on the industry and can boost the sector's stability.

8. Role of Gender in the Financial Services Industry

The vast majority of goal-driven managers in the financial services industry are male, and the global financial sector crisis has largely been blamed on men for the culture of excessive risk taking. Psychological research suggests that women are less somewhat willing when compared to their male counterparts to take extreme risks. This raises the question of whether or not a greater gender balance within the financial services industry would have resulted in a different outcome for the financial sector globally? Research from London Business School further asserts that an equal male/female split in a management team is best for the promotion of innovation and better decision-making (Express Section 2, April 29, 2009). In light of such a situation, does this really affirm that the financial sector may have fared better with a greater, more balanced proportion of women managing the industry?

The Sunday Economic Times in Bombay, published the results of a study showing that the nine-listed companies managed by prominent women fared better than the top 30 firms listed in the Bombay Stock Exchange for the last five years. These companies operate in a wide range of industries from biotechnology, entertainment, healthcare and media to chemicals and engineering; not just the stereotypical "female" companies. In another example, almost half of all private companies in the United States are majority-owned by women, generating US\$ 2.5 trillion in annual sales, and employing across the U.S. approximately 19 million people. Women undoubtedly do have an important role to play within numerous industries and do make a substantial difference, and potentially they may as well make the same difference within the financial services industry as asserted by Ruth Sealy¹².

¹² Deputy Director of the International Centre for Women Leaders at Cranfield University (2009).

9. Regulatory and Supervisory Frameworks

With the rapid expansion of the financial sector, there were always concerns as to whether the supervisory and regulatory frameworks were in place to support the expansion and stability of the industry (Stokeley Smart 2012¹³). Smart (2012) expressed concern given that individual regulators specifically assigned to each of the various branches of the financial services sector is quite distinct and isolated from the others. He suggested for better coordination among the various branches of the financial sector- a Risk Assessment Committee be established to deliver a comprehensive analysis of the potential systematic risks that may be faced in the sector and the national economy.

In Trinidad and Tobago's context substantial resources must be added to the Central Bank followed by appropriate legislation and other infrastructures to protect all players. The Credit union movement controls billions of dollars in revenues yet remains largely unregulated. New regulatory measures must be developed, and supervisory and regulatory bodies have to be given new responsibilities in light of the rapid expansion of the credit union movement.

Regulatory and supervisory systems of the financial sector are currently receiving global attention in response to the effects of the present financial crisis. The government of Trinidad and Tobago has revised the Financial Institutions Act to provide for consolidated supervision as well as cross border supervision and information sharing. Additionally, the Insurance Act was being redrafted to allow for more stringent supervision and regulation.

According to Sargeant (2001), perhaps the greatest challenge to monetary policy will come about when there is greater use of digital money (based on either the smart card or on computer network money). Digital money can affect the balance sheet and reduce seigniorage income of Central Banks while any security breach could severely disturb the financial system. Additionally, there is the concern that digital money could facilitate money laundering, fraud, and tax evasion. While these proved to be a challenge for some of the weaker companies to adjust, the opportunity for strengthening the financial system through the promotion of higher levels of efficiency, soundness and corporate governance existed.

Yet, the very crisis that exists today is reflective of the fact that regulators have simply not mastered the job of regulation, if they had; such a crisis of magnitude proportions occurring may have been minimized and perhaps even circumvented. Ewart Williams¹⁴ (2009) cites four key reasons for the poor performance of regulators, these are:

1. The rapidly evolving innovation and creativity in terms of services and products being offered by financial institutions.
2. The recognition that risk taking should not be totally outlawed since under certain conditions it could benefit consumers.
3. The fact that laws cannot legislate good behaviour or by extension, good governance.
4. An ideological shift towards free markets and minimal regulation.

Sabga (2012) articulated that we must act now to update our regulatory framework and corporate governance systems to ensure that there is adequate oversight, reporting and accountability. The fact is that any financial institution committed to taking excessive risks with policyholders' and depositors' funds, exploiting loopholes, and in bending the system can go undetected even for a short while and in so doing cause extensive damage. In light of this, and in direct response to the current financial crisis, the Group of 20 (G-20) met in London (April 02, 2009), and at that Summit, financial regulatory reform was proposed and these are as follows:

- The extension of financial regulation and oversight to all financial institutions, instruments and markets, as well as, to hedge funds and credit rating agencies.
- The creation of a new Financial Stability Board, with a strengthened mandate and expanded membership to replace the Financial Stability Forum.
- The endorsement of new principles for sound compensation practices at major financial firms.

¹³ Stokeley Smart (2012), "Why the Financial Services Sector Needs a Risk Assessment Committee", Business Express, April 25th 2012.

¹⁴ Ewart Williams, Governor of the Central Bank of Trinidad and Tobago (2009)

- A call for accounting standard setters to work with regulators in order to improve standards on valuation and provisioning, achieve a single set of global accounting standards and to reduce the complexity of accounting standards for financial instruments.
- To take action against non-cooperative jurisdictions, including tax havens, which do not share information on request.

The extent to which such measures will lead to profound changes given the way business is conducted is left to be seen. As noted by Williams (2009), financial regulation is most effective when supported by an adequate legislative and regulatory framework; an effective supervisory system, highly trained regulators; a regime of supporting and supportive institutions such as the accounting and auditing profession and support from an informed and vigilant investor community-or market discipline. However, it is important to understand that even with the aforementioned confluence of supporting factors, problems can still occur. A seamless regulatory and supervisory framework is difficult to institute. Cooperation on the part of all stakeholders and players in the industry on a global scale is necessary since in the context of globalization, actions of one country will have an impact on others.

10. Public Policy

Government policies do have a major influence on the development and stability in the financial services industry. Through extensive government intervention in the form of public policy, financial reform continues to be implemented, liberalization encouraged and measures administered to enhance prudential regulation and tackle bank distress.

Over the years, public policy has demanded increased transparency and open competition in the banking sector. New competitors will be empowered in the market place and mergers will be discouraged since this will reduce competition. It is clear that the government will assist credit unions to restructure and better compete with banks. It may also allow money market mutual funds and life insurance companies to join the payments system and also pave the way for the establishment of segregated funds by insurance companies. This will effectively end the monopoly that deposit-taking institutions have on offering transactions balances. With a money market account that pays a decent rate of return and comes with a cheque-book and a debit card you may no longer need a bank account. Mutual fund companies will offer one-stop-shopping for transactions and investment needs, with the ability to move money easily across a family of mutual funds, secure in the knowledge that your money market funds are safe and can be used for every day payments.

In light of the challenges that may face the financial sector in the future, the sector must take the necessary steps to become more competitive in the provision of its services. This will require the re-examination and re-organisation of systems and processes. There is need for improvement in the supervisory and regulatory framework in some aspects of the financial systems especially in the areas of insurance and credit unions. In this regard, global developments have direct implications for other countries and should be the basis for informing the way forward.

Global Developments and Implications for Trinidad & Tobago

Several developments in the international sphere have direct implications for the ability of Trinidad & Tobago to achieve its defined vision of becoming a developed country by 2020. These developments are occurring in the spheres of trade, finance, regulation and supervision, technology and currency.

Trade and financial liberalisation are proceeding internationally along a variety of fronts. Under the General Agreement on Trade in Services (GATS), services liberalisation requires countries to progressively open services trade which have implications for the level of competition with the local financial sector. There is also immediate impact given the efforts of trade liberalization under the CSME¹⁵. These include free movement of goods, services, labour and capital, right of establishment and common trade policy.

In the area of supervisory developments, the Basel Committee on Banking Supervision has been introducing new supervisory requirements, which represents international standards that progressive countries have been adopting.

¹⁵ CSME- Caricom Single Market and Economy

The Central Bank of Trinidad & Tobago has implemented and continues to implement many of these measures. In particular, assessments by local and independent bodies have found the country to be largely in compliance with the Basel Committee's Core Principles. While the main areas of deficiency are legislative, amendments to address these weaknesses have already been proposed and new legislations are in the making.

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 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.

With regards to technology, the Internet facilitates the cross-border supply of financial services by unlicensed foreign financial service providers. This presents a significant challenge for local authorities to regulate the activities of these providers. As well, 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 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 (Ministry of Finance Green Paper, 2003).

Of particular note, in the sphere of currency is the lobbying of a United Nations panel for a new global currency reserve scheme to replace the volatile, dollar-based system (Business Guardian, April 02, 2009). The United Nations asserts that a new Global Reserve with regular or cyclically adjusted emissions calibrated to the size of reserve accumulations could potentially contribute to global stability, economic strength and global equity, thereby replacing the current system which is increasingly being criticized as relatively volatile, deflationary and unstable. Suggestions have even been made by China to replace the reserve currency by an International Monetary Fund (IMF) basket comprising dollars, yen, euros and sterling. The problem with such a suggestion, however, is that a two or three country reserve system may be equally unstable. As recommendations and suggestions come to the fore regarding the existing dollar-based global currency reserve system, there are considerable implications for all countries, including Trinidad and Tobago if such changes are to be effected in the future.

Finally, Trinidad & Tobago in its 2020 vision to become a leading financial center will have to ensure that local financial institutions comply with a number of local and international laws. These include the Proceeds of Crime Act 2000, the Money Laundering Guidelines, the relevant clauses of the United States Patriot Act 2002, Federal Reserve System Law revised in 2005, and the Banking Laws Amendment Bill 2011. It is felt that when these come on stream it is likely to provide a challenge for central banks and other policy makers.

Conclusion

The winds of change are indeed blowing towards the financial services sector. The changes are of paramount importance to all the key players in the market, as well as, to the stability of the financial service industry itself. It will determine whether they remain competitive or not. The challenge is there for all of us – industry leaders, policy makers, legislators, regulators, and consumers – to manage the changes that are occurring in a way that best serves our collective interest.

Advances in wireless technology are bringing us closer to the point when we can access any information from any mobile service. Each user is going to have his own applications and personalised voice data to tap into the Internet. The mobile phones market will explode because of the interactive wireless functions that can be executed. After all, the glories of the wireless Internet, mobile commerce, short messaging, and global positioning services are being touted as crucial, can't-miss functions (Tausz, 2001). Financial institutions are continually exploring new technology developments in order to provide customers with the world-class choice, convenience and reliability they expect.

The challenge for financial institutions is to remain on the cutting edge of technologies that can reduce costs and add value, while staying in step with customer's needs as the convergence of communications technologies opens up a host of new options for customers to do most things differently. To offer the latest leading-edge solutions, financial institutions must continue to pursue effective strategic partnerships with IT industry leaders- or risk losing their competitive edge (Somerville, 2000).

Security will remain a key issue in the implementation of new technology applications. All parties in a transaction should know for certain that the people they are doing business with are who they claim to be. Who knows whether dollarisation and e-currency (distinctly digital money on the Internet) would radically change the financial sector, something that Singapore intends to introduce.

While the revolution within the financial services sector continues, the issue of unpredictable financial crises as is currently being experienced globally continues to present a challenge of magnitude proportions for the industry. As such, structures, mechanisms and controls must be instituted as a matter of priority in an attempt to minimise the effects of the potential ‘fallout’ that is taking place globally with the collapse of the largest financial institutions around the world.

Financial institutions that can offer a more personalised relationship to their customers and confirm their use of world class practices will survive. Those that cannot will lose their competitive edge, and eventually lose customers and even whole markets. Cyberspace, therefore, may not be the final frontier or the only frontier, but it is a necessary frontier where, eventually, everyone in the banking industry will have to boldly go (Maharaj, 2001).

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