

# **An Analysis of the Legislative Reform Proposals for Credit Unions of Trinidad and Tobago**

**By**

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Credit Unions in Trinidad and Tobago have been in existence since the early 1940s. The Cooperative Societies Act No. 22 of 1971, which replaced the old Ordinance of 1952, provides for their operations and functioning. Since 1971 the most significant, perhaps the only, revisions made to the Act had to do with the removal of restrictions on interest rates levied on loans and dividends payable on shares. Prior to these amendments CUs were legally restricted to a maximum of 12% per annum on loans, and 8% per annum as dividend on shares. Even though the restriction, especially on loans, has been removed the majority of Societies continue to operate by the former guidelines because they perceive that such rates provide an advantage over competitors.

Between the years 1974 and 1983 Trinidad and Tobago enjoyed "boom conditions" resulting from the quintupling of oil prices and consequently substantial oil revenues. Most financial institutions achieved significant growth in revenues, savings, loans outstanding and profitability during this period because the business environment was bouyant. The Credit Unions too achieved significant growth in their numbers and the resources they commanded (Table 1) refers. A close look at Table 1 reveals that all

banks and credit unions enjoyed significant growth in profits up to 1983. However, when the economy went into decline the banks began to realise considerably lower profits while the credit unions appear to have maintained fairly good performance. We believe that as liquidity in the banking sector tightened, banks began to ration credit and therefore fewer loans were granted. Credit unions seized this opportunity as persons who could not access funds from commercial banks turned to them and were provided with loans.

By 1983 the economic fortunes of the country had changed and financial institutions began to feel the effects of liberal lending decisions. Banks, in particular, made huge provisions for loan losses. Weaknesses in risk assessment, credit analysis and probably management, which were masked by profitability during the "boom" period became glaring. These problems lead to the failure of several financial institutions and consequently the formation of the Deposit Insurance Corporation. Khan, 1992 suggested that while credit unions have made tremendous advances and significant contributions to the economy since their establishment, there was much to be desired in terms of managerial competence and operational efficiency. He concluded that wholesale changes were necessary to make to sector competitively viable. Perhaps Khan's suggestion found resonance in official circles since later in 1992 a Task Force was appointed by the Cabinet of Trinidad and Tobago to review and to make recommendation's with respect to certain aspects of the operations of credit union.

**Table 1 (a)**  
**Trinidad and Tobago: Selected Commercial Banks**  
**Profits Before Tax (consolidated) TTS'000s**

Commercial Bank	1974	1978	%Δ	1983	%Δ	1986	%Δ
Workers Bank	-744.4	1,206.2	262.0	17,445.0	1346.2	10,462.0	-40.0
Royal Bank	8,117.2	29,553.4	264.1	80,821.0	173.4	29,518.0	-63.4
Republic Bank	5,161.0	20,036.0	288.2	84,394.0	321.1	21,833.0	-74.1
N.C.B.	818.7	5,422.8	562.3	13,865.0	155.6	12,557.0	-0.94
Scotia Bank	4,820.0	14,372.0	198.1	56,619.0	293.9	42,205.0	-25.4

**Table 1 (b)**  
**Credit Union sector: Total Savings and Total Loans Outstanding**  
**(Selected Years) TTS'000s**

No. of Credit Unions*	Savings	%Δ	Year	Loans Outstanding	%Δ
93	40,916.8	-	1944	36,844.0	-
119	128,848.6	214.9	1978	112,659.7	205.7
133	477,286.4	270.4	1983	473,261.7	320.0
137	976,611.6	104.6	1986	902,157.7	90.6

\* The variation of number of credit unions reporting shows the lack of compliance with the Cooperatives Societies Act which mandates that all CUs report annually. However, the values reported were not altered significantly since mainly small CUs were delinquent.

Source: Khan 1992, p. 116  
 Khan 2001 pp. 116-117

In general, the terms of reference of the Task force required them to examine credit unions and to make recommendations that would address issues such as; delinquency, the enforcement power of the Cooperative Department, to develop a programme to improve supervision of credit unions, to recommend prudential criteria and accounting standards, and others matters relevant to the sound regulation of the credit union sector. A number

of major recommendations were put forward by the Task Force but for the purposes of this paper we identify two which we consider to be the most significant, and which we believe had the potential for wide ranging effect:

- i) that there should be an amendment of the cooperative legislation to provide for the separate regulation and supervision of credit unions by a new supervisory agency responsible to the Minister of Finance; and
- ii) that there should be a general review of the cooperative legislation with a view to modernising certain of the provisions which have become obsolete with the passage to time.

Since the completion of the work of the Task Force, the Government of Trinidad and Tobago in conjunction with the Cooperative Credit Union League of Trinidad and Tobago and the Inter-American Development Bank have agreed on an “Institutional Strengthening Project” for the local credit union sector. The IDB has agreed to provide TT\$6.8 million in non-reimbursable grant funding with the Government and the Credit Union League providing counterpart funding. The project was started in October 1999 and should conclude by June 2002.

The issues which will be discussed in this paper form part of proposals being suggested for the improvement of the credit union sector. Our analysis is not exhaustive of all the proposed changes, such discussion would be beyond the scope of this brief paper.

However, we believe that the areas being covered are of singular importance for the success of Credit Unions. We shall, therefore, focus on the following:

- 1) Capacity and Power;
- 2) Financial Services;
- 3) Capital and Liquidity;
- 4) Directors and Credit Committee;
- 5) Regulator of Credit Unions;
- 6) Deposit Insurance; and
- 7) Licencing of Credit Unions.

### **Capacity and Power**

The Cooperative Societies Act requires credit unions to provide evidence of a common bond<sup>1</sup> before they can be registered. The majority of Societies are either occupational or residential. The bond is supposed to reinforce the notion of a cooperative society as a kind of mutual support system. More important though is its virtue that group loyalty will somehow ensure that members of the group respect their obligations thereby minimising the prospect of loan default. It is perhaps useful to mention here that commercial banks enjoy an advantage over CUs because of their ability to process asymmetric information.

There appears to be a trend nowadays for credit unions to pursue expansion and growth activities by opening their bonds. Some CUs now have the ability to conduct business

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<sup>1</sup> A Common bond may be based on either occupation, association or residence within a well-defined group.

country-wide. This raises questions about the fraternal relationship that is thought to exist among cooperative institutions, since by encroaching on others space some societies are inevitably doomed to failure. This is not necessarily a bad thing though as it is likely to result in fewer but stronger entities as competition eliminates the weaker credit unions.

The new provisions will provide a fillip, especially to large credit unions, as it proposes that they be allowed to conduct business outside of Trinidad and Tobago once the laws in the other jurisdictions permit. They will be restricted to the provision of financial services, primarily to members, depositors, subsidiaries and affiliates. On the surface, this appears to be a good innovation since a strong financial institution would be able to expand and grow by regionalising or internationalising its operations. It is also a useful way for credit unions to continue providing services to members who may have migrated but still retain membership with the societies. Organisations in Jamaica are already engaged in providing such services. The Victoria Mutual Building Society has a branch in England.

What is of greater concern is the expansion into branch networks by some large CUs. Though there have been significant advances in general operations we believe that branch expansion seriously stretches the limits of credit union management, technology and risk assessment. In the area of credit assessment in particular, credit unions still rely on trust. There is no system, as exists in the banking sector, for making reference checks on loan applicants, to determine whether a borrower has loans at other CUs and has a good repayment record. What these issues suggest to us is that the regulator needs to reconsider the issue of bonds and their relevance today.

### **Financial Services**

Most Credit Unions in Trinidad and Tobago provide basically three types of financial services; shares and deposits (savings), and loans. A few of the large institutions engage in other activities such as foreign exchange transactions and investment instruments. The new proposals will seek to expand allowable services to include; portfolio management, issuing payment credit and charge cards, and operating payment credit and charge plans.

We believe that these are very futuristic ideas that would probably catch on in another five to ten years. There is currently no credit union in Trinidad and Tobago which has the capacity to issue and monitor credit or debit cards. In-house risk management expertise is inadequate, and the required technology is absent. The costs involved in acquiring those requisites are too prohibitive for an individual society. The Credit Union League has been coordinating an effort aimed at providing limited plastic card services through a commercial bank but the service is not available yet. From the perspective of the users, not many persons are interested in obtaining such services from their credit unions. A survey being currently undertaken by the author reveals that most individuals hold cards from banks and those persons would not like the CUs to expend huge resources to supply such services. Those persons without cards have no interest in them whatever.

### **Capital and Liquidity**

The proposed provisions will seek to ensure that credit unions maintain good capital protection. At the moment the PEARLS standard is used by local societies to monitor individual performances. Recent financial reports reveal that most institutions perform

satisfactorily in this area. One area of concern is the type of investment in which credit union reserves are placed. It should be mandatory that the bulk of reserves are placed in blue chip investments. However, there are several institutions which currently use reserves to fund loans. This, we believe, is a very bad practice which could threaten the stability of the institutions because of the inherent risks associated with loans. The new provisions should include a clause restricting the above activity to ensure the safety and soundness of credit unions. Non-compliance should attract severe penalties.

### **Directors and Credit Committees**

Whatever the form of organisation the quality of decision-making and hence success or failure is determined by the calibre and competency of management. Of course, other factors such as the economic environment and the technology in use may inhibit success but in the absence of good management failure is inevitable. In all credit unions the Board of Directors is supreme. Given the responsibility that is attached to that office, Boards must be adequately staffed. The issue of safety and soundness of the financial system is paramount in these times. To achieve those objectives require good internal controls which derive from good policies and oversight. These are functions of the Board of Directors. To our mind, the new provisions do not go far enough in ensuring the quality of Boards and Committees.

The officers of both the Board and Credit Committees are currently elected at the Annual General Meeting (AGM) of credit unions. The former may comprise up to a maximum of twelve individuals while the latter comprises a maximum of five persons. Any



member who is duly nominated and seconded by members of the society may be elected to office. There are no specific formal qualifications or experience requirements which prospective candidates must satisfy in order to be elected to office. The only requirement that has been articulated is age eligibility, which specifies that office-seekers must be over the age of eighteen years. It appears that other issues are still to be formulated.

We have serious difficulty with the existing procedures for electing credit union officials. The age limit for office holders should be raised to 30 years old. What experience and skills can an 18-year-old bring to the decision-making process of a financial institution? Many of the societies control huge financial resources, and are involved in very sophisticated transactions. The latter suggests that Boards must be comprised of persons who possess the relevant skills and knowledge that will allow them to be effective. Sadly, this is not the case and consequently many boards waste considerable time trying to facilitate those members who are ill equipped for the boardroom. What is worse, however, is that Presidents and other Board members of most credit unions command very little respect from the society at large, because they hold no positions of equal importance in their professional lives. Can you imagine the problems that are likely to occur when persons with little or no policy-making experience are charged with such responsibility. Combine this with no practical experience or training in the area and perhaps it provides an indication of the need for institutional strengthening.

In the case of the Credit committee we believe that the function of this entity is largely invalidated by the existence of loan officers in most credit unions. In the institutions

where there are no loan officers the credit committee is indispensable but where trained loan officers are employed there is the possibility of much duplicity and wastage. In credit unions which employ loan officers there is normally a chain of referral by which loans are reviewed and approved by either a supervisor, manager, credit manager or general manager. This is a kind of selection process to ensure that loans satisfy eligibility criteria and are of acceptable risk. Compare the previous scenario to a Credit Committee, which is elected and likely to be constituted by persons without either training or experience in lending but who possess the power of rejection or approval. As far as we are concerned this is an anachronism, especially in the large credit unions. In some institutions loans in some categories can be approved without referral to the Credit Committee but this is the exception rather than the rule.

We believe that credit unions would be better served by trained lending officers, especially since most borrowers approach these institutions because of favourable lending rates and perceived flexible policies. It is no longer a case of inability to access loans from the established financial institutions. The role we envisage for the Credit Committee is to function as a review committee which examines loans approved and makes comments and recommendations to the Board in order to assist policy formulation. An additional responsibility which it can share with the Board is in approving loans in excess of the manager's limit. This is currently practised by some credit unions to varying degrees. We do not believe, however, that credit union managers are allowed enough discretionary powers, and this leads to over-involvement by the Boards in the day to day running of the society. This situation has to be changed.

## **Regulation of Credit Unions**

The responsibility for regulation of credit unions currently resides with the Cooperative Department and is exercised through powers conferred upon the Commissioner of Cooperatives. It is generally believed that the manner in which the Department discharges its functions renders it inadequate. Consequently, it is not highly regarded and hence there tends to be a lack of respect for regulatory authority. This situation has resulted in non-compliance among some credit unions, even willingness to contravene the Act, since sanctions are non-existent. It should be noted, however, that limitations imposed by scarce human resources, inadequate and outdated technical and administrative systems, and weakness in the law rather than dereliction of duty by the Cooperative Department, contributed significantly to the existing situation. Currently the Cooperative Department has vacancies for 25 cooperative officers out of an establishment total of 57 officers. But this is not the only problem with respect to human resources. While the credit unions have updated their systems and staffing the Department continues to rely on the Cipriani Labour College for its officers. At that institution persons can obtain an Associate Degree in Cooperative Studies. We do not believe that such qualifications are sufficient for officers who have to monitor credit unions which have become very sophisticated in their operations.

To indicate how serious the problem of non-compliance is, data on the number of active credit unions is almost impossible to verify. Current estimates by the Credit Union Supervisory Unit of the Ministry of Finance put the total number of Societies at 143, with

126 active institutions, but financial data were available for only 96 credit unions. It has been suggested that thirty CUs have not reported in three years. Table 2 shows the inconsistency of credit unions reporting to the Credit Union League. Perhaps those statistics indicate how difficult it is to conduct proper analysis of credit unions in Trinidad and Tobago and also shows why a new regulator is necessary. This is precisely what the proposed provisions suggest. It provides for a regulator to be appointed by the Minister of Finance, someone of proven financial experience. The function of regulator will be performed by the Inspector of Banks in the absence of a regulator. We are totally in agreement with the proposed changes and wish to see wide powers given to the regulator to censure and wind-up credit unions that default or become insolvent.

**Table 2**  
**Trinidad and Tobago:**  
**Credit Unions Statistics**  
**(1985-2000)**  
**TT\$000s**

Year	No. of Credit Unions	Total Loan Balances	Total Savings
1985	73	175,173	179,166
1986	108	249,263	267,185
1987	108	216,625	251,728
1988	140	155,209	260,214
1989	134	160,371	269,368
1990	128	1,014,126	1,167,736
1991	127	1,113,140	1,349,935
1992	129	1,322,430	1,383,892
1993	129	2,670,103	2,770,220
1994	92	2,253,997	2,498,271
1995	92	2,014,846	2,413,290
1996	92	1,065,543	1,276,447
1997	99	1,565,551	1,856,260
1998	97	2,013,480	1,751,781
1999	96	1,699,779	1,975,720
2000	64	1,814,460	1,982,166

Source: Cooperative Credit Union League of Trinidad and Tobago

### Deposit Insurance

There have been previous attempts at the establishment of a central financing facility. First, there was the Credit Union Cooperative Bank which never fulfilled its promise and which ran into difficulties in the 1990s. It was treated like a bastard child by its parents (credit unions) which never gave it their full support. It has been effectively closed since 1992. Currently in existence is the Credit Union Stabilisation Fund, whose stated objective is to engender confidence in the credit union system by ensuring:

- (a) the protection and stability of member units through preventative and/or curative assistance; and
- (b) the security of members' shares and deposits.

The Fund, established in 1994, appears to be experiencing better success than the Bank did but like that institution it does not enjoy the full support of the credit union sector. At December 1998 only forty credit unions were members of the Fund. The new entity being proposed will require mandatory membership for all credit unions receiving deposits. This is a positive step since CUs do not appear to respond favourably to voluntary participation. However, we wonder why consideration is being given to reinventing the wheel. The existing Deposit Insurance Corporation (DIC) has been in existence for over 15 years and has proved itself capable of providing relief to depositors affected by the failure of financial institutions. Small countries like ours do not possess an over supply of trained human resources, and the skills required for running another entity will not be readily accessible. In any event, the number of CUs which are likely to be affected are about 17. Table 3, reveals that there are only six credit unions with assets in excess of TT\$100 million each. Perhaps only the last two groups in Table 3 receive substantial deposits.

**Table 3**  
**Trinidad and Tobago: Credit Unions**  
**By Asset Size, and Total Assets (1999 and 2000)**  
**Local Currency**

<b>Asset Size</b>	<b>No. of Societies</b>	<b>1999 Total Assets</b>	<b>2000 Total Assets</b>	<b>%Δ</b>
< \$25 million	35	273,078,042	295,018,204	8.03
\$25-50 million	12	359,981,929	381,717,576	6.03
\$50-100 million	11	646,959,973	102,324,609	8.56
>100 million	6	1,148,011,975	1,217,668,942	6.06
<b>Total</b>	<b>64</b>	<b>2,428,131,919</b>	<b>2,596,729,331</b>	<b>6.94</b>

**Source:** Cooperative Credit Union League of Trinidad and Tobago

We do not believe that credit unions are on the periphery any more. They are comfortably part of the recognised financial services industry. There is no need for a separate entity, and we believe that steps should be taken for credit unions to access membership to the already established DIC.

#### **Licencing of Credit Unions**

The existing arrangements make it very easy for a new credit union to be registered. Perhaps this situation accounts for the 35 new societies registered between 1985 and 2000. Upon completion of the prescribed application form and payment of a fee of TT\$10.00, the Commissioner may register a credit union if he is satisfied that:

- i) there are at least twelve members among whom exist a common bond;
  - ii) the prospective society has submitted three copies of its proposed by-laws;
- and

- iii) the society has complied with the law and its by-laws are in accord with cooperative principles.

The extant law imposes no burden on the Commissioner to ensure the viability of the proposed society. Consequently, a credit union can be registered without the assurance that there are persons among its membership who possess the required skills and experience for operational effectiveness. Doubtless, such practice, combined with poor oversight by the regulatory agency contributes to the weaknesses evident in the sector.

The new licencing provisions, because they will demand a recent feasibility study on the financial viability of prospective credit unions, are likely to ensure stronger, better managed societies. However, we believe that the sector may already be over subscribed with credit unions and therefore entry conditions for new societies should be very high. For instance, prospective societies should be required to show evidence of a strong capital base, as a condition for being granted a licence. Currently a credit union share can be purchased for TT\$5.00 and that share entitles the holder to enjoy all the benefits of the society including voting rights. In our opinion persons seeking membership to a society should be required to make an initial investment of TT\$500.00 in shares, with the nominal value of each share being TT\$100.00. This is a paltry sum given the level of income in the country today. We agree with the proposed licencing proposals but believe that they can be improved with the above suggestions.



## Conclusions

The proposed provisions will impose very demanding conditions on credit unions but it also allow a period within which societies could meet those conditions. There is likely to be a *fallout since many of the existing institutions may not be able to meet acceptable standards* resulting in either the closure or merger of weak and inefficient units. There should be no compromise in the areas of capital adequacy and the composition of Boards. We believe, however, that there is need to distinguish between those societies which are social organisations and those perceived as financial institutions. The credit unions *which consider themselves to be social organisations are generally not inclined to seek growth as an objective.* They are usually small, generally closed institutions which rely heavily on voluntarism . They tend to be based on occupational bonds without much scope for increasing membership. Perhaps these societies ought to be treated as separate from those credit unions which aggressively pursue growth and expansion. Most of the *latter are comprised of branch networks, and offer a wide range of products and services.* Essentially, these institutions are considered as alternatives to banks and other financial intermediaries. The bulk of the members of these societies are middle class professionals, not the so-called 'small man' that credit unions were created to serve.

*Many credit union leaders have raised concerns about the proposed regulations* but very few can deny that the existing regulations and the regulatory agency are inadequate and ill-suited to the current environment. We hope that the new regulations are soon enacted to allow for a stronger more resilient credit union sector. We have abiding faith in the ability of credit unions to make a valuable contribution to the society as a whole.

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