Financial Inclusion and Financial Literacy in a Post-COVID Environment

Remarks by **Governor Cleviston Haynes**
to the Barbados Association of Insurance and Financial Advisors (BARAIFA)

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Good morning.

When I spoke with you last February, I marvelled at how much our lives had changed over the previous year. Today, we are still in the midst of a pandemic that has overturned our way of life, reversed our anticipated growth trajectory, while undoing some of the progress we had made in restoring our economy along the path of fiscal and debt sustainability.

However, as I reported in my review of the economy for 2021, there are encouraging signs that the conditions for economic recovery are under way, and most macroeconomic indicators are trending in the desired direction.

With the easing of restrictions, both here and internationally, tourism activity has started to rebound, resulting in positive spill-overs to the rest of the economy. Sporting and entertainment events are now back, noticeably evident by the activity surrounding the ongoing cricket Test match between the West Indies and England. In recent weeks, we have also welcomed our children back to school, if only part-time at this stage, and more workers have returned to office.

The heightened level of economic activity is evidenced in the employment statistics, with the most recent estimate of unemployment by the Barbados Statistical Service indicating that the unemployment rate for the last quarter of 2021 fell to 10.9 percent from 12.4 percent three months earlier.

COVID-19 caused government to relax its fiscal stance over the past two years, with a consequential need to increase borrowing from abroad. However, the revival of economic activity, together with the revenue measures announced this week, is expected to enable a reversion to a moderate primary surplus in the coming fiscal year as government seeks to restore fiscal and debt sustainability.

The new borrowing undertaken by Government has served to cover the financing gap induced by the loss of revenue and the need to raise expenditures to safeguard lives and livelihoods. The debt-to-GDP ratio has increased, in large measure because we are producing less than in the pre-COVID period. However, it is important to recognise that the increase in the debt stock is less than the new borrowing, as Government continues to pay down domestic debt. In addition, the stronger the economic recovery, the sooner we can expect a reversal of the debt-to-GDP ratio.

The borrowing has had a favourable impact on our international reserves, which now exceed $3 billion or 40 weeks of imports, both historic highs. This reserve accumulation has created a buffer to absorb the external impact of the rising costs of imports.

At the beginning of the year, we spoke of the potential for the economy to register a double-digit recovery in 2022. The resurgence in activity in the tourism sector is expected to drive growth, supported by a pick-up in investment spending by the public and private sectors. We must remain mindful, however, that significant downside risks to the pace of that recovery exist.

First, while our source markets for tourists have generally eased restrictions on travel and economic activity, the potential for the emergence of new variants of the virus that dampen demand remains.

Second, the severe disruptions being experienced in the global supply chain have the potential to delay implementation of investment projects which are so crucial to accelerating the pace of the recovery.

Third, energy and commodity prices trended upwards in 2021, creating domestic inflationary pressures. The advent of the war in the Ukraine has aggravated the situation, to the extent that prolonged conflict could dampen tourist demand. Already, airlines are warning of possible hikes in airline tickets. Apart from the impact of tourism activity, domestic spending could also be affected by continued sharp price increases, which have the potential to erode real incomes. The significance of these factors will depend on how long the conflict lasts and its long-term impact on prices.

The recent budget has sought to provide some relief from the increase in import costs, but the capacity of the state to absorb these price increases through a substantial lowering of tax rates or the provision of subsidies is generally limited at this time, without creating unsustainable financing gaps and increasing public sector indebtedness.

The financial system has remained resilient during this challenging period. The banking sector continues to register high levels of liquidity and capital. The proactive measures put in place early in the pandemic have helped to contain the level of non-performing loans and ensure that the sector remains stable.

As we seek to promote the economic recovery, how can we adapt the financial system to play a central role in Barbados' recovery? I want to focus the remainder of my comments this morning on emerging developments that have the potential to assist in transforming the efficiency of the financial system.

Financial Inclusion

Our financial system continues to be dominated by the banking sector. However, the emergence of large credit unions over the past four decades has tempered that dominance, particularly in the market for household savings and loans. All evidence suggests that there is widescale access to banking services. Indeed, a 2020 report by the IDB (InterAmerican Development Bank) found ATM and branch concentration in the island to be high, and almost 100 percent of the people surveyed in 2016-2017 had a savings or chequing account with a financial institution.

However, there remain periodic complaints of limited access to banking services, whether through the inability of individuals to open accounts because of a lack of adequate documentation, the inability to access credit facilities, particularly for small business, or the absence of product offerings that make doing business easier.

I do not propose to address account opening this morning, but we do anticipate that the launch of Barbados' digital ID card will make account opening easier in the coming months.

The ability to open and maintain an account is only one aspect of financial inclusion. The opportunity for individuals and businesses to access financing at reasonable rates is another.

While access to financing is theoretically possible, the requirements with regards to collateral can make it impractical or even impossible, either because there is none or the level of collateral exceeds the size of the borrowing facility. This reflects the fact that lenders with fiduciary responsibility for depositors' funds are often risk averse. As we seek to propel growth and unlock the creativity, imagination and innovation within the small enterprise sector, we must therefore find new ways to assist SMEs (small and medium enterprises). In the past, the Bank has provided credit guarantees to assist in unlocking new credit. However, funding through such schemes is limited by the capital of the guarantee fund and by the decision of financial institutions to lend in the first instance.

Credit Reporting

It is in this context that I wish to draw to your attention that Government recently passed the Fair Credit Reporting Act that provides a framework for the establishment of a licensing regime for credit bureaus. Transitional provisions are incorporated for entities operating in the credit reporting space prior to the passage of the Bill.

Credit reporting as envisaged under the Act allows for a risk-based approach to lending, rather than an environment where lenders are unaware of the borrower's track record and therefore demand substantial guarantees to protect themselves from losses.

In practical terms, this means for example that the owner of a small bakery, who, over the years, has taken out several small loans to upgrade his/her equipment and even purchased a van for deliveries, could now be approved for a larger loan on the basis of his/her repayment history. This could allow this entrepreneur to take his/her business to the next level on more favourable terms than might now happen.

The Central Bank of Barbados will undertake responsibility for licensing and supervising the activities of credit bureaus, with power to conduct investigations and issue sanctions including license revocation and financial penalties. Such supervision is critical given that all customer data must be treated fairly. You must rest assured that your information will be stored securely and made virtually immune from abuse.

Under the legislation various entities will be designated as credit information providers. Financial Institutions, credit unions and insurance companies (insofar as their credit portfolios are concerned) will be automatic credit information providers. Over time, other entities providing forms of credit via both the private and public sectors will be designated as credit information providers depending on the strength of their compliance systems.

By broadening the coverage of credit information providers, all providers of credit will be able to make better credit decisions on whom to lend, how much and at what price, for the pricing of loans bears a relationship to perceived risk. As individuals and small businesses develop a track record of servicing their obligations, they should benefit from lower cost funding.

The Act also provides dispute mechanisms that will not initially require recourse to litigation. The dispute resolution measures should reduce the time and costs associated with civil action and relieve the civil courts of some of their burden via the establishment of a specialised tribunal. The drafting of the legislation for this tribunal, is also underway. This tribunal will also hear and determine complaints relating to payments and other financial services.

Digital Services

Technology continues to drive the delivery of financial services. Indeed, globally, there is increased prevalence of digital products. At home, we all know of the boost that e-commerce provided as a means of combatting the spread of COVID-19. Many of us already effect online transfers to make payments. The ongoing upgrade to the ACH (automated clearing house) system facilitates real time transactions. Some institutions have experienced delays in completing testing in relation to the transition to real time payments, but some banks already have the capability. By early August we anticipate that at least two of our large credit unions will also have the capability.

This could be a game changer. We believe that this is the first step towards the offering of mobile wallet transactions across the financial system, thus enhancing the efficiency and speed of payments. In addition, cash transfer programming or direct funding to beneficiaries can be made via electronic payment systems, as was done by Government with disbursements of NIS payments during the pandemic. As we move to reduce the use of paper instruments, including cash and cheques, we anticipate greater use of these electronic payment systems.

The growth of digital banking is seen as the ideal catalyst to promote financial inclusion and enhance resilience and competitiveness. EY, reporting on the impact of these developments on banks in Singapore, highlighted that digital banks initially targeted the underserved market segments such as SMEs and gig workers. In addition, a survey conducted there showed that 70 percent of the young banking customers were amenable to digital bank offerings. There is no reason to believe that our young people will not be similarly captured.

I can say to you that we recently licensed our first digital bank and believe that incumbent banks that wish to compete effectively will need to move swiftly to upgrade their technological platforms. Competition fuels innovation and demands greater efficiency, without which businesses stagnate. History is littered with examples of giants becoming complacent and then swiftly losing ground. Kodak and, more recently, Blackberry are two examples. The increased use of technology offers the potential for improvements in service and faster payments as well as for better customer relationship management.

Already, competition is coming from non-traditional players. For example, retailers are branching out to offer financial services, emerging tech companies are providing digital solutions, and peer-to-peer lending is expanding. The growing presence of non-bank institutions offering unsecured loans presents competition to regulated institutions. Traditional players will need to re-orient their thinking and expand and diversify their products and services to meet the needs of consumers who are now more demanding.

As regulators we will also have to adapt by expanding our skill sets and developing new tools because at the end of the day, whether it is a chequing account or a mobile wallet, our role is to protect the consumer. In this regard, some of these non-traditional players will also have to be regulated in relation to the services they provide in the payments space.

Financial Literacy

I want to close by touching on financial literacy.

It is news to no one that an educated population is good for a country. This is certainly true of the financial system. As financial advisors, you want to see a public that understands the basics of budgeting, saving, and investing.

We often assume, for example, that everyone knows how credit cards work. Credit cards are a useful payment option, and one that is widely used – I'm sure many, if not most of us here today, have at least one. But for people who do not recognise that they are a form of debt, or who make only the minimum payment each month, they can quickly become a serious financial burden.

Over the past year, there was much debate on the costs of transactions as financial institutions transitioned from CarIFS to Visa and debit cards. Eventually the Bank intervened, providing relief to customers, but some complaints reflect the lack of adequate knowledge about different products in the financial space and how we can reduce the cost of financial services to ourselves. I believe that financial institutions and we as regulators will have to do more to enhance literacy on these matters.

In the absence of financial literacy, people can become susceptible to predatory lending arrangements or get-rich-quick scams, leaving them unable to meet their debt obligations, which, on a sector level, leads to an increase in non-performing loans.

Without the appropriate education, they are also vulnerable to financial fraud, and may even find themselves participating unwittingly in money-laundering and being used to channel funds for illicit activities. But even when it doesn't result in people falling prey to criminals, poor financial literacy is still a handicap.

The public debate on the rise in popularity of blessing circles demonstrates an appetite for alternative investments among our citizens at a time when interest rates are very low. However, I would issue a general caution that where investment returns appear to be substantially above market norms, these are usually investments of which one needs to exercise increased due diligence and care.

As I mentioned earlier, a goal of the new credit reporting legislation is to create opportunities for individuals and businesses who might not have qualified for loans before, or for whom the requirements would be too steep, to secure financing. This may be achieved based on evidence of a strong credit rating.

For people whose credit history is spotty, it could have the opposite effect, as it may become more difficult for them to get additional loans if they have a pattern of poor repayment. In a sense, this may save them from becoming further overextended.

That may be necessary but, in all cases, what is preferable is that we ensure that people understand the importance of budgeting and arranging their finances in a way that ensures that they are able to meet their obligations in full and on time.

To this end, as part of our public education around credit reporting, we've spent time focusing on the importance of a strong credit rating and on how to go about getting one.

There's another reason financial literacy is important.

How much Barbados is able to capitalise on the wider array of financial products and services, including digital solutions that are now available will depend on how comfortable consumers are with them, and that comfort level is improved through financial education.

As investment advisors you have a potential role to help in this area. I therefore renew our commitment to work with you and other relevant agencies in enhancing the level of public education around financial services.

I thank you.