Trinvest Advisors, LLC

Consolidation of Caribbean Financial Services: Value of Scale

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In his conference call discussing the divestment of smaller units in the Caribbean, Scotiabank CEO Brian Porter said that the decision is part of a broader strategy to "*sharpen our focus, increase scale in core geographies and businesses, improve earnings quality and reduce risk to the bank*."

This consolidation is a global phenomenon; In the US, the top 5 banks currently hold 40% of domestic deposits, up from 20% in 2000. The number of small banks (US$10 billion or less in assets) has declined from 8,263 in 2000 to 5,961 in 2014. It is a case of go big or go home.

Value of Scale
Looking at Scotiabank's strategy of:

- sharpen our focus
- increase scale in core geographies and businesses
- improve earnings quality
- reduce risk to the bank

What are the drivers to lower risk and better margins for scale? I believe that the 3 Fs: **FATCA, Fintech and Financial Crisis** have raised the fixed cost and risk components to all institutions in an equal way, without regard to size. This has erected barriers to entry and hurt the profitability of smaller institutions, who are forced to spend the same amounts to keep up with regulatory and technological change. The consolidation can initially drive profitability of the larger institutions, with the big Caribbean banks reporting ROAs of 2-3% and ROEs of 15+%. However, longer term, that same technological change can pose a threat. Competitors will look at each segment of the business to find ways to use technology to disintermediate incumbent institutions. Where will e-commerce platform companies look to provide safer, better financial products with less friction for the client to view and access services?

- Deposit taking/safekeep of savings
- Distribution/sales of insurance products
- Investment product choices and management
- Payment Transactions
- Cambio and currency exchange
- Loans
- Credit cards

Per Citi's Global Perspectives and Solutions Group in March last year:
"the question for banks today is how do they become Digital Banking Superstars versus going the way of the dinosaurs. The future of finance is an ever increasingly converged ecosystem where consumer and small and medium enterprise (SME) financial services are provided by banks and by platform companies with roots in e-commerce and social media. For an incumbent bank to become a Bank of the Future and not remain stuck in the past, they must look not only at new technologies such as artificial intelligence, machine learning, and other forms of automation, but they must also look to overhaul their operational systems and technology systems."

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An example in Trinidad is the website www.compareTT.com, which offers an easy, one point access for consumers to shop providers for car insurance, personal loans, mortgages, credit cards, TV packages, phone packages and more. While this service is mostly informational with the ability currently to only apply for products directly to selected providers, it does remove much of the friction of shopping providers for financial services and puts the power of information in the consumer's hands. As technology eases the ability to move money and change services, consumers will be driven more by price.

The domestic Caribbean hard currency deposit and investment base makes a good example of a profitable segment subject to competition. This deposit/investment base has been dominated by indigenous institutions due to the high friction cost of alternatives. Consumer selection is restricted, and profit margins are high. According to the Central Bank of Trinidad and Tobago, 26.4% of Commercial Banks' TT$104 billion in deposit liabilities is *Foreign Currency Liabilities*, most with a 0% cost of funds. This does not include an estimated USD 2-3 billion in non-bank financial institutions, mutual funds, unit trusts, foreign currency repos or other domestic providers geared to hard currency financial services.
https://www.central-bank.org.tt/statistics/data-centre/commercial-banks-annual

Transparency of choice and lower friction will give the consumer the choice to easily move from a 0.25% rate on a US$ deposit at an incumbent bank to another higher rate. Technological tools and platforms are developing attractive alternatives that can enter the market to capture these investments and deposits. Stickiness of deposits and frictions to change remain high but will be eroded over time. The disparity between available returns has also been growing, adding an incentive for consumers considering alternatives.

Financial service companies face the difficult decision on when and if to embrace new ways in quickly evolving markets. What is my sustainable competitive advantage and how susceptible are I to price competition? Are my products and distribution channels unique to me? We are moving into a brave new world where institutions cannot only rely on their name and legacy business.

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