

**DEVELOPING AN INTEGRATED FINANCIAL MARKET
STRATEGY TO FACILITATE GROWTH IN THE EASTERN
CARIBBEAN CURRENCY UNION (ECCU):**

Strategic Imperatives

Work in Progress

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EXECUTIVE SUMMARY

INTRODUCTION

ECCB's ongoing money and capital markets development program is integral to promoting a sound financial structure conducive to the balanced growth and development of the economies of the Eastern Caribbean Currency Union (ECCU). Initiated in the latter part of the 1990s, the program fosters the development, integration and regulation of a single *financial space* through the creation of both markets and institutions to achieve this goal. These include the Eastern Caribbean Home Mortgage Bank (ECHMB) to develop and maintain a secondary market for mortgages, the inter-bank market for short-term liquid funds, the Eastern Caribbean Securities Market (ECSM) infrastructure, a new uniform consumer price index and the Eastern Caribbean Institute of Bankers. In August 2002, ECCB expects to see the first government issue its securities on its newly designed regional government securities market system. Other institutions planned for establishment include the Eastern Caribbean Enterprise Fund (ECEP) and the Eastern Caribbean Unit Trust (ECUT).

WHY DON'T WE YET SEE THE FULL IMPACT AND BENEFITS OF THE MONEY AND CAPITAL MARKETS DEVELOPMENT INITIATIVES INTRODUCED SO FAR

Despite the notable progress made in the last few years, the OECS financial sector still lacks the diversity of institutions and mechanisms deemed essential for efficient allocation of capital to the productive sectors of the region's economies. Further, the gains of the above-mentioned newly formed institutions and mechanisms will only be realized if complementary reform measures are introduced within the region's economies.

In the ECCB region, over 70% of assets are still held by the banking sector. The limited type of financial instruments available includes: a) treasury bills, b) government bonds and c) private corporate securities. The financial sector in the countries is small, fragmented and has limited liquidity. Non-bank financial institutions are limited and not integrated into the overall financial system. Social security schemes, insurance companies and credit unions do not play a major role in capital markets intermediation. Most of their capital accumulations are held in bank deposits. There is a lack of well-developed collective investment vehicles such as mutual funds or unit trusts. The recently formed ECSM is a noteworthy regional endeavour aimed at financial integration but it still has a limited number of listed companies. The base of public companies is limited, existing public companies are slow to respond to a listing on the ECSE and there is no venture capital development yet in the region.

The Government Securities Markets in the 8 countries are not well developed; the positive attributes of such a properly functioning market are yet to be realized. High fragmentation of markets within the 8 countries has resulted in allocative inefficiencies. OECS countries are incurring high borrowing costs arising out of their existing arrangements with Trinidad and Tobago financial institutions that are assisting in the issuance and placement of government-sponsored securities. A regionally integrated market with uniform placement and auction procedures is critical to ensure placement of such securities on attractive terms.

Rapidly evolving business models and the changing competitive landscape in the OECS member countries is mandating corporations to not only re-assess their business strategy but also the capital raising process used to finance growth and expansion. Large exposure to one particular class of financial assets (i.e., bank loans) coupled with rising interest costs are hurting the *bottom-line* and further stifling expansion plans of firms within the region. Although high leverage by itself may not be an indication of capital starvation (as may be the case for some regional companies), it does indicate that too much of the firms' finance is based on term borrowing, thereby leaving them exposed to fluctuations in the business cycle. It may also indicate that the firms' have reached the debt limits, and that further finance for expansion will only come from equity or retained earnings. Further, sources of equity financing within one country by itself may not be enough to fund large investment plans by companies.

When a region's financial system (like the OECS) relies heavily on its banks, systemic vulnerabilities increase. A well-developed financial market with a broad array of institutions and instruments helps to alleviate the systemic risk associated with one class of financial asset playing a pervasive role in the allocation of capital. Non-bank financial institutions consisting of securities markets, insurance companies, collective investment vehicles, credit unions, social security schemes/pension funds and venture capital are an integral part of the financial system, providing an alternative intermediation mechanism for mobilization and allocating savings, for managing risk and liquidity, and for facilitating government debt management. The non-bank financial sector reduces the financial vulnerability of enterprises through improved access to equity markets and less dependence on short-term bank debt, through the re-financing risks of governments in a domestic public debt market, and through the banking system's term transformation risks. Empirical evidence has shown that financial markets with depth and breadth are able to manage crisis better than markets without them.

The presence of a well-functioning government securities market is also very critical to the overall financial system. Partly because of their unique characteristics, especially their minimal credit risk, government securities and the deep, liquid markets in which they are traded have come to play important, if not critical, roles in facilitating aspects of private finance. In particular, they have facilitated the pricing and management of financial risks associated with private financial contracts. Government securities also have played important roles in facilitating effective banking. For example, these markets have provided banks and other financial institutions with the opportunity to use credit-risk-free government securities to manage their considerable interest rate risks. Such markets have characteristics that, together, distinguish them from private securities. These characteristics have allowed the government securities market to play certain roles that may not easily be played by private financial products and their markets. These roles are: a) providers of benchmark rates for reference or pricing in private sector fixed-income markets, b) hedging vehicles, c) vehicles for funding financial market positions and managing liquidity, d) instruments for investment and position-taking on the level of interest rates, and e) "near monies" and safe havens. A well functioning government securities market is vital for the development of corporate bonds. The development of the corporate bond market, however, is essential to the region's economies and its development should be assigned the highest priority.

INTERVENTIONS DEEMED NECESSARY BY ECCU HOST COUNTRY GOVERNMENTS TO ENSURE A BALANCED FINANCIAL SECTOR THAT PROVIDES FOR SUSTAINABLE ECONOMIC DEVELOPMENT IN THE REGION

A well co-ordinated effort will be needed by the existing financial sector institutions, private sector and governments to ensure the above-mentioned balanced financial sector strategy is in place to ensure economic growth. This coordinated effort will need to address the following 7 areas (along with a list of interventions needed in each area) that are critical to the future growth of the individual economies:

- 1. Addressing the gap between savings and investments in the region**
- 2. Mobilizing domestic savings through a diversified base of institutions and instruments**
- 3. Reduction of flight of capital from home markets to developed securities markets**
- 4. Development of a productive private sector**
- 5. Need for inflow of foreign savings through portfolio investment inflows**
- 6. Supportive legal and regulatory structure**
- 7. Comprehensive Marketing, Education and Awareness Program to Support an Integrated Initiative**

I. Addressing the Gap Between Savings and Investments in the Region

Interventions needed include:

- ***Influencing Banking Institutions to Offer Competitive Lending Rates***
Moral suasion will be needed to encourage the banking institutions in the region to re-assess their lending rates.
- ***Social Index***
Banks within the region could be encouraged to produce a social index on a periodic basis that compares changes in the financial institution's investments within the productive sectors of the OECS region as compared to those made outside the region.

II. Mobilizing domestic savings through a diversified base of institutions and instruments

Interventions needed include:

- ***Privatisation Program***
Governments could use a privatisation program to sell part of statutory corporations to strategic investors, with the remaining to be made available for sale to OECS nationals through a public offering and a residual amount to be retained by the Government for future sales. This would increase the number of listings on the

ECSE, provide diversified product for institutional and retail investors and also foster a diversified shareholder base and ownership culture within the region.

- ***Encouraging Initial Public Offerings***

Rapidly evolving business models and the changing competitive landscape in the OECS member countries is mandating corporations to not only re-assess their operating strategy but also the capital raising process used to finance growth and expansion. Firms need to raise public equity and the same on a region wide basis. Incentives could be accorded by governments at the time of company incorporation and registration (as well as for existing companies) to encourage them to go public. The most commonly used incentive is a lower corporate income tax rate for public companies. Open companies may receive other benefits, such as exemptions of dividends from taxes, eligibility for tax holidays not available to closed companies, special depreciation allowances and special allowances for bank debts.

- ***Encouraging the Public Companies to List***

A number of the prominent public companies within the countries are yet to list their securities on the ECSE. These same very companies enjoy certain concessions from their governments. It would be helpful if governments were to use some form of *moral suasion* with these companies to expedite their listings on the market. This would increase liquidity as well as allow for a broader base of OECS investors to take ownership in companies. Perhaps, a regulation mandating all public companies to seek listing on the ECSE could be considered.

- ***Efforts by Commercial Banks Serving as Intermediaries***

A number of commercial banks within the 8 countries have established relationships with their corporate clients. Commercial banks ought to encourage these clients to diversify their capital base and seek more equity through the public market. Banks should work closely with leveraged companies to determine innovative approaches to dealing with fixed assets that are pledged against the loans undertaken. A way to capitalize/securitize some of these loans in an attempt to allow the company to facilitate the issuance of equity would not only serve to reduce the high level of indebtedness but also provide for new equity to be raised from outside sources. ECCB could also consider providing incentives to banks that are successful in encouraging their corporate clients diversify their capital base.

- ***Secondary Market for Distressed Debt***

Development of a structured secondary market in loans would increase liquidity and persuade borrowers, banks and other market participants of the merits of realising values by disposing of assets. Several measures can foster the development of a secondary market for debt in the region: a) standardisation and simplification of the sale agreement for loans, b) establishment of standard settlement procedures, c) establishment of codes of practice for market activity, and d) establishment of mechanisms for transparent valuation of loans.

- ***Listing of Corporate Debt of Private Companies within the ECCU***
Some private companies within the ECCU have shown their reluctance to stage an Initial Public Offering (IPO). A preferred option for some of these private companies might be to list debt instruments.
- ***Listing of Off Shore Companies***
A number of off shore companies have been registered within the ECCU. Some of these companies may wish to have their securities listed on a reputable securities exchange. A scrutinised effort will be needed in conjunction with the governments to ensure that there is a proper basis and framework for selecting from such companies to list on the ECSE.
- ***Asset Backed Securities***
Securitization can be used to sell performing and impaired assets and holds great promise for banks in the OECS region seeking to dispose of assets. OECS commercial banks, as originators of mortgages and quality loans, could sell/pass these assets to an institution that will be responsible for repackaging the securities (the arranger). The securities would then be underwritten by brokerage firms and re-offered to the public via the ECSE. Commercial Banks could also undertake similar roles for other forms of assets such as personal loans, car loans and account receivables. The ECHMB should be used a preferred vehicle for the arrangement of such a securitization program.
- ***Cross-Listings***
The present ECSM market infrastructure and legislation does not allow for companies from outside the OECS to cross-list on the ECSE. The same is critical to increase the number of listings as well as provide the liquidity needed for the market to develop.
- ***Facilitate the Development of the Regional Government Securities Market (GSM)***
As indicated earlier, OECS countries are facing high borrowing costs arising out of their existing arrangements with Trinidad and Tobago financial institutions that are assisting in the issuance and placement of government-sponsored securities. A regionally integrated market with uniform placement and auction procedures is critical to ensure guarantee of such securities at more attractive terms. Further, the need to develop bond markets to complement the role of banking institutions in financing long-term projects is of the utmost strategic importance. The development of domestic bond markets needs to evolve in a systematic fashion. The key ingredient for a buoyant corporate bond market is a well functioning market for government debt. A strong government bond market provides an ideal learning ground to achieve pricing and trading skills without the distraction of credit risk.

The ECCB, with the help of the ECSE, has put together a cohesive program for the successful implementation of a regional market for primary issuance of government securities. Host country governments need to show urgency in adapting to this new regimen as its success will lead to better pricing and placement of securities by

issuing governments as well as ensuring future success of the corporate bond market in the region.

- ***Developing Institutional Investors – The Case of the ECUT***

One of the fundamental questions is whether retail investors should be encouraged to directly participate in the primary market (the usual situation in developing economies) or indirectly through institutional investors. In developed markets, institutional investors provide screening services. They use their expertise, knowledge, market contacts and private information to more accurately assess the prospects of firms going public. ECCB, in its money and capital markets development initiatives, has always been aware of the need to ensure that all of the peoples of the region benefit from the opportunities unlocked by the markets. It is recognised that, in order to ensure viable markets; the needs of both the institutional and individual investors are addressed. In the new market environment, the institutional and larger individual investor is satisfactorily accommodated with the broker-dealer arrangements that are in place. The small investor, however, with lower levels of investment funds may find these benefits harder to derive. In order to address this, a regional investment vehicle, such as the ECUT, is critical for the region.

- ***Unleashing Restrictions Placed on Social Security Schemes/National Insurance Schemes***

A uniform policy and code of conduct for investment departments of these institutions needs to be implemented on a region wide basis. Such institutions should be allowed to have an increased portion of their fund accumulations placed in securities markets, in addition to bank deposits and government securities-which are some of the only investment choices available at this time. These schemes should also be allowed to invest freely within the OECS region-notably in companies listed on the ECSE. Investments in foreign securities should be gradually phased in based on the maturity of the investment management industry and the availability of instruments, or lack thereof, in the domestic market. The basis for establishing portfolio limits on investments should be undertaken by a committee comprising of market and investment professionals drawn from the region and elsewhere. A regional regulator responsible for monitoring and overseeing the conduct of social security/national insurance scheme arrangements would be useful for the region.

- ***Establishment of Investment Clubs in the Region***

The concept of investment clubs could play a very positive role in the development of a securities market and an educated base of investors. Governments should accord special incentives for the creation of such entities in their jurisdictions.

- ***Exploring New Opportunities for DFIs and Credit Unions: Regulatory and Operational Changes***

Regulation of DFIs as part of the standard banking sector supervision in host-country banking systems is an important step forward towards formalising prudential financial requirements of DFIs and allowing for standardising their information disclosure.

As part of their changing role, DFIs would want to consider the possibility of investing in “hard” as well as “soft” infrastructure of securities markets. “Soft” infrastructure involves funding the establishment and institutional development of market intermediaries- broker-dealers, investment funds, etc., and “hard” infrastructure relates to funding the development of market infrastructure, namely: clearing and settlement systems; depositories to facilitate dematerialization of securities, capable registrars to improve the safe custody and administration; and trading systems that ensure a transparent price discovery mechanism, and a liquid secondary market. A number of countries have considered the possibility of allowing DFIs to serve as “window agencies” for brokering securities of corporate issuers (as part of capital market facilitation for investors). Independent **credit rating** agencies that evaluate and monitor outstanding credit risks, and provide for critical information are absolutely critical as the region’s markets move towards a level of maturity. DFIs in the region could get together to form a regional credit agency.

Some of the new areas for diversification in securities markets for DFIs mentioned above, could also be explored for relevancy to the credit union industry.

- ***Exploring the Basis for Forming Real Estate Investment Trusts (REITs)***

REITs are companies dedicated to owning and, in most cases, operating pools of income producing real estate, such as apartments, shopping centres, offices and warehouses. Some REITs are also engaged in financing real estate. REITs mobilise debt and equity in the capital markets and thereby create a direct link between real estate valuations and the cost of capital. The prospects for setting up REITs in some of the countries of the OECS where development of real estate will be key to the future, is something worth an examination by governments.

III. Reduction of Flight of Capital from Home Markets to Developed Securities Markets

There are a significant number of entities and individuals openly soliciting investments from our regional population in securities from outside the OECS region. This is resulting in large amounts of capital being siphoned away to promote the growth and development of enterprises outside the region. While the same is difficult to control, it becomes all the more important for us to increase the availability of regional financial instruments to our investing population-so that domestic capital can foster the growth and development of the region’s very own enterprises.

The Securities Act of 2001 expressly states that anyone engaged in securities business within the region needs to obtain a license prior to performing such a business activity. Moreover, it is critical that those individuals promoting the sale of foreign securities to the OECS population get these registered with the Eastern Caribbean Securities Regulatory Commission.

IV. Development of a Productive Private Sector

Interventions needed include:

- ***Development of Venture Capital Institutions- The Case of the ECSE***
The ECSE has created the need as well as opened up an opportunity to attract venture capital to the region. Venture capital now has an exit mechanism through the ECSE. Central to the long-term success of the ECSE is the ability to expand listings beyond the current base of public companies. Risk aversion and a strong dividend culture among the current investor base in the region are major obstacles to attracting capital to high risk, start-up firms. The existing investor base is likely to migrate towards established firms in the region that have a strong track record of dividends. With the establishment of the regional securities market infrastructure, existing public companies will be exposed to the entirely new experience of market monitoring. Firms with insufficient borrowing capacity or depressed stock prices could find it difficult to obtain financing on reasonable terms in the public debt or equity markets. ECCB's proposed Eastern Caribbean Enterprise Fund (ECEP) initiative will serve as a regional investment/venture capital fund, which will access domestic and international capital for private sector development. It is proposed that the ECEP would provide both equity and loan capital, directly or indirectly through other institutions, for all aspects of private sector enterprise development. The full participation of the domestic institutions, including the commercial banks and other nonblank financial institutions, in providing capital resources would be critical.

Certain sectors targeted for growth and investment will serve as the priority areas for investment by the ECEP. Emphasis on investment will be placed on companies with a true regional focus.

- ***Establishment of a Regional Chamber of Commerce and Industry***
An effort has been initiated to establish an OECS Chamber of Commerce and Industry. Consolidation is likely to be the name of the game in most of the industries within the OECS, and it is for this reason that a regional chamber may be in a better position to influence change in the government-private sector relationships within the region.
- ***Establishment of a Regional Accounting and Auditing Association***
The success of the domestic capital market is largely dependent on the adoption of internationally recognizable financial standards and codes of good practice. There is a need to establish a regional association that encourages companies to comply with quality accounting standards (accuracy, relevance, transparency, corporate governance, comprehensiveness, timeliness) and international conventions. Such an association could be set up as a Self-Regulatory Organisation (SRO) falling under the regulatory purview of the Eastern Caribbean Securities Regulatory Commission (ECSRC).

V. Need for Inflow of Foreign Savings through Portfolio Investment Inflows

A primary source for infusion of capital into the productive enterprises as well as in the secondary market will come from foreign institutional investors seeking diversification. Bell-weather firms that form part of the ECSE index will benefit from such investors pursuing index

investing. Availability of institutional capital for companies could also reduce cost of corporate borrowing.

Governments will need to relax alien-shareholding requirements and taxes related to purchase and sale of securities to allow for free movement of portfolio investments into the region. Foreign institutional investor participation will be key to increased liquidity and transparency in the ECSM.

Non-OECS nationals are presently not allowed to freely participate (alien shareholding restrictions apply) in the buying and selling of securities in the ECSM market. As part of the region's commitment to adhere to the requirements of WTO protocols and those within CARICOM, the same will have to be reviewed. Participation by investors from the broader Caribbean and elsewhere will have to be phased in to comply with these requirements.

VI. Supportive Legal and Regulatory Structure

- ***Unified Approach to Supervision***

The complexity of global markets, the increasing rate of change within industries and the growth of financial conglomerates has placed an enormous strain on systems with multiple and overlapping regulatory and supervisory structures. Common concerns about market stability have led to a greater degree of international discussion about two methods for enhancing it: supervision of market participants and imposition of market discipline. International organizations have recently developed minimum standards for supervision of financial intermediaries and for timely accurate disclosure of material information by market participants. **Super Regulator** is a term that describes a recent trend in financial sector supervision where all or some supervisory agencies of various financial sectors (e.g., banking, insurance, capital markets, non-banks, and/or social security/pension) are combined into a single legal entity.

The basis for a unified supervisory action over all the financial market institutions in the ECCU needs to be closely studied. No matter what alternative structure is used, the pressures to enhance regulatory and supervisory frameworks to deal with the integration of financial markets will continue with the changing financial sector paradigm in the region.

- ***Removal of Legal Impediments and Exemption of Transfer and other Related Taxes***

Host-country governments will need to harmonize pieces of other relevant legislation (e.g. companies act, taxation act, etc.) to that of the Securities Act. The ECSE is designed to operate as a regional market within the ECCU. To support this initiative, member governments of the ECCU will need to continue providing exemptions to OECS nationals from all taxes related to the purchase of securities traded on the ECSE, as well as to waive the alien land holding licence requirements. Further, the same concession will need to be granted to investors from outside the region to allow for increased depth and liquidity in the market. Further, taxes on capital gains, dividends and withholdings

for investors would need to stay completely removed. Moreover, favourable tax treatment for all investors will be key to the overall success of the securities market in the region.

- ***Licensing and Registration of Outside Individuals/Entities and Foreign Financial Products***

As noted earlier, individuals engaged in the securities business and promoting the sale of products (from outside the ECCU) in our regional market need to obtain a proper license from the ECSRC. It is also critical that those individuals promoting the sale of foreign securities to the OECS population get these registered with the Eastern Caribbean Securities Regulatory Commission (ECSRC).

VII. Comprehensive Marketing, Education and Awareness Program to Support Such an Initiative

One of the major problems confronting the OECS region is the lack of awareness among certain sections of the population as to what is really taking place in the financial sector. While the ECCB and the ECSE have been embarking upon a comprehensive marketing, education and awareness program, the same is not enough. Further, costs for rollout of such programs is exorbitant. Dedicated commitment will need to be made by host-country governments to make available free airtime as well as share in the costs of promoting the new financial sector institutional arrangements and opportunities for all affected parties. A comprehensive effort that includes the activities of the ECSE, GSM, ECUT, ECEF and other related institutions would need to be addressed jointly using a combination of communication tools.

BACKGROUND

The Monetary Council in the early 1990s had mandated the Central Bank to proceed with the activation of Article 4(3) of the Agreement which states that the purposes of the Bank are “*to promote credit and exchange conditions and a sound financial structure conducive to the balanced growth and development of the economies of the territories of the participating Governments*”. This was interpreted to mean, in practical terms, the development of money and capital markets. The latter part of the 1990s heralded the onset of a new era of financial sector development in the region.

The Currency Union as we know is one that has had a common currency and a common central bank, but eight separate markets. In recognition of this fact, ECCB set upon the goal for the development, integration and regulation of a single financial space within the region. It began by launching the creation of both markets and institutions to achieve this goal.

So, where are we now? The Eastern Caribbean Home Mortgage Bank (ECHMB) established by ECCB to develop and maintain a secondary market for mortgages already has a track record of paying dividends in its last two years of operation. With respect to markets, ECCB has already established the inter-bank market for short-term liquid funds. In October 2001, it launched the Eastern Caribbean Securities Market (ECSM). The ECSM now comprises the full complement of institutions, namely:

- a) Eastern Caribbean Securities Regulatory Commission which is responsible for licensing persons engaged in securities business, ensuring investor protection, maintaining effective compliance and enforcement programs and promoting the growth and development of the capital market;
- b) Eastern Caribbean Securities Exchange which is designed to facilitate the buying and selling of financial products;
- c) Eastern Caribbean Central Securities Depository (ECCSD), wholly owned subsidiary of the ECSE responsible for providing clearance and settlement of trades transacted on the ECSE; and
- d) Eastern Caribbean Central Securities Registry (ECCSR), a wholly owned subsidiary of the ECSE, responsible for maintaining records of securities (stocks and bonds) on behalf of issuers in a dematerialised environment.

Also, during the October 2001 period, in collaboration with the statistical offices of each member country, ECCB rolled out a new consumer price index, which for the first time in the history of these islands was compiled on the basis of a common methodology and using the same base year. An adjunct institution, which ECCB helped to establish with the whole-hearted support of the commercial banking community, is the Eastern Caribbean Institute of Bankers whose role is to increase the expertise in the financial sector. In August 2002, ECCB expects to see the first government issue its securities on its newly designed regional government securities market system.

A PARADIGM SHIFT IN THE FINANCIAL SECTOR OF THE OECS REGION IS CRITICAL TO FUTURE ECONOMIC GROWTH AND DEVELOPMENT

Building an Integrated Financial System

Despite the above-mentioned progress, the OECS financial sector still lacks the diversity of institutions and mechanisms deemed essential for efficient allocation of capital to the productive sectors of the region's economies. Further the gains of the newly formed institutions and mechanisms (indicated above) are yet to be fully realised.

When a region's financial system relies heavily on its banks, systemic vulnerabilities increase. A well-developed financial market with a broad array of institutions and instruments helps to alleviate the systemic risk associated with one class of financial asset playing a pervasive role in the allocation of capital. Non-bank financial institutions consisting of securities markets, insurance companies, collective investment vehicles, credit unions, social security schemes/pension funds and venture capital are an integral part of the financial system, providing an alternative intermediation mechanism for mobilization and allocating savings, for managing risk and liquidity, and for facilitating government debt management. The non-bank financial sector reduces the financial vulnerability of enterprises through improved access to equity markets and less dependence on short-term bank debt, through the re-financing risks of governments in a domestic public debt market, and through the banking system's term transformation risks. Empirical evidence has shown that financial markets with depth and breadth are able to manage crisis better than markets without them.

The presence of a well-functioning government securities market is also very critical to the overall financial system. Partly because of their unique characteristics, especially their minimal credit risk, government securities and the deep, liquid markets in which they are traded have come to play important, if not critical, roles in facilitating aspects of private finance. In particular, they have facilitated the pricing and management of financial risks associated with private financial contracts. Government securities also have played important roles in facilitating effective banking. For example, these markets have provided banks and other financial institutions with the opportunity to use credit-risk-free government securities to manage their considerable interest rate risks. Such markets have characteristics that, together, distinguish them from private securities. These characteristics include: a) minimal credit risk, b) high liquidity and a wide range of maturities, and c) well-developed market infrastructure. These characteristics have allowed the government securities market to play certain roles that may not easily be played by private financial products and their markets. These roles are: a) providers of benchmark rates for reference or pricing in private sector fixed-income markets, b) hedging vehicles, c) vehicles for funding financial market positions and managing liquidity, d) instruments for investment and position-taking on the level of interest rates, and e) "near monies" and safe havens. A well functioning government securities market is vital for the development of corporate bonds.

The development of the corporate bond market, however, is essential to the region's economies and its development should be assigned the highest priority. A common phenomenon in

developing economies is the diminished role of the government in the economy. Therefore, there has to be a corresponding increase in the mobilisation of funds from the corporate bond market. To facilitate this massive shift in responsibility for supply of developmental funds, several major strategic and policy changes need to be unleashed. Primary among them is universal recognition of and concrete implementation of steps to designate the corporate bond market as the engine of growth. A strong focus on credit risk is required. Effective, credible and independent credit rating agencies are required to develop models and assess credit risk. Regulatory bodies should promote the use of ratings. Credit rating agencies should develop procedures consistent with international best practices.

Present Situation

In the ECCB region, over 70% of assets are still held by the banking sector. The limited type of financial instruments available includes: a) treasury bills, b) government bonds and c) private corporate securities. The financial sector in the countries is small, fragmented and has limited liquidity. Non-bank financial institutions are limited and not integrated into the overall financial system. Social security schemes, insurance companies and credit unions do not play a major role in capital markets intermediation. Most of their capital accumulations are held in bank deposits. There is a lack of well-developed collective investment vehicles such as mutual funds or unit trusts. The recently formed ECSM is a noteworthy regional endeavour aimed at financial integration but it still has a limited number of listed companies. The base of public companies is limited and there is no venture capital development yet in the region.

The Government Securities Markets in the 8 countries are not well developed; the above-mentioned attributes of such a properly functioning market are yet to be realized. High fragmentation of markets within the 8 countries has resulted in allocative inefficiencies. Further, OECS countries are incurring high borrowing costs arising out of their existing arrangements with Trinidad and Tobago financial institutions that are assisting in the issuance and placement of government-sponsored securities. A regionally integrated market with uniform placement and auction procedures is critical to ensure placement of such securities at attractive terms.

Sources of equity financing within one country by itself may not be enough to fund large investment plans by companies. There is a need for risk capital and the ability to raise the same on a region-wide basis. Large exposure to one particular class of financial assets (i.e., bank loans) coupled with rising interest costs are hurting the *bottom-line* and further stifling expansion plans of firms within the region. Although high leverage by itself may not be an indication of capital starvation (as may be the case for some regional companies), it does indicate that too much of the firms' finance is based on term borrowing, thereby leaving them exposed to fluctuations in the business cycle. It may also indicate that the firms' have reached the debt limits, and that further finance for expansion will only come from equity or retained earnings.

INTERVENTIONS DEEMED NECESSARY TO ENSURE A BALANCED FINANCIAL SECTOR THAT PROVIDES FOR SUSTAINABLE ECONOMIC DEVELOPMENT IN THE REGION

A well co-ordinated effort will be needed by the existing financial sector institutions, private sector and governments to ensure the above-mentioned balanced financial sector strategy is in place to ensure economic growth. This can be facilitated through the process of consultation between public and private sector, where a common blueprint is endorsed, which contains a list of interventions needed, and the principles, standards and practices underlying them and the priorities for implementation. This co-ordinated effort will need to take into account the following:

1. Addressing the gap between savings and investments in the region
2. Ways to mobilize domestic savings through a diversified base of institutions and instruments
3. Reduction of flight of capital from home markets to developed securities markets
4. Development of a productive private sector
5. Need for inflow of foreign savings through portfolio investment inflows
6. Supportive legal and regulatory structure
7. Comprehensive Marketing, Education and Awareness Program to Support an Integrated Initiative

The interventions required for each of the above and the basis for implementing the same are provided below:

Addressing the Gap Between Savings and Investments

Influencing Banking Institutions to Offer Competitive Lending Rates

Moral suasion will be needed to encourage the banking institutions in the region to re-assess their lending rates. An effort has been initiated by the ECCB in this direction and the same will need to be further pushed with the help of governments as well.

A Social Index

Banks within the region could be encouraged to produce a social index on a periodic basis that compares changes in the institution's investments within the productive sectors of the OECS region as compared to those made outside the region.

Ways to Mobilize Domestic Savings Through a Diversified Base of Institutions and Increased Number of Financial Instruments

Increasing the Number of Financial Instruments

Privatisation Program

A number of statutory bodies within the region are government-owned but could be termed as commercial enterprises. Prime examples are the utility companies (electricity,

water) in most of the countries that are either a department within the relevant ministry or 100% government-owned corporations. Some countries also have banks that fall under the classification of a statutory body. The commercial orientation of these enterprises calls for them to be in the private sector. Governments could use a privatisation program to sell part of these companies to strategic investors, with the remaining to be made available for sale to OECS nationals through a public offering and a residual amount to be retained by the Government for future sales. This would increase the number of listings on the ECSE, provide diversified product for institutional and retail investors and also foster a diversified shareholder base and ownership culture within the region. Most importantly, it would allow governments to divert their resources to other priority areas of economic- and social- development. Privatized entities not only provide sales proceeds but also become tax paying entities; thereby providing added revenues to the government.

Encouraging Initial Public Offerings

Rapidly evolving business models and the changing competitive landscape in the OECS member countries is mandating corporations to not only re-assess their operating strategy but also the capital raising process used to finance growth and expansion. Large exposure to debt coupled with rising interest costs are hurting the *bottom-line* and further stifling expansion plans of firms within the region. Firms need to raise public equity and the same on a region wide basis. The ECSE and local Chambers of Commerce need to develop a cohesive strategy of apprising businesses of the changing role of the financial system in the OECS region and the opportunities for public offerings accorded by the new Eastern Caribbean Securities Market (ECSM). Ongoing emphasis will be required to familiarise Caribbean businesses with the regulatory and operational framework developed for this newly created market as well as provide a detailed road map for companies wishing to issue equity and seek a listing on the ECSE.

The larger private-owned companies within the country could also be incentivized through some tax-breaks in the event that they decided to go public. The most commonly used incentive is a lower corporate income tax rate for public companies. A minimum differential of 10 percentage points (assuming a corporate tax rate of 40-50% for closed companies) to have an appreciable effect. The effectiveness of this differential may be increased further when the tax authorities pay special attention to companies that are obvious candidates for going public but have not done so. Open companies may receive other benefits, such as exemptions of dividends from taxes, eligibility for tax holidays not available to closed companies, special depreciation allowances and special allowances for bank debts. ECSE plans to research these areas for relevance within the region and work with governments in this area.

Incentives could also be accorded by governments at the time of company incorporation and registration in an attempt to encourage new businesses to go public.

Seeking Assistance from Host Country Governments to Encourage Companies to go Public and List

A number of the prominent public companies within the countries are yet to list their securities on the ECSE. These same very companies enjoy certain concessions from their governments. It would be helpful if governments were to use some form of *moral suasion* with these companies to expedite their listings on the market. This would increase liquidity as well as allow for a broader base of OECS investors to take ownership in companies.

Efforts by Commercial Banks Serving as Intermediaries

A number of commercial banks within the 8 countries have established relationships with their corporate clients. Commercial banks ought to encourage these clients to diversify their capital base and seek more equity through the public market. If need be, banks should work closely with leveraged companies to determine innovative approaches to dealing with fixed assets that are pledged against the loans undertaken. A way to capitalize/securitize some of these loans in an attempt to allow the company to facilitate the issuance of equity would not only serve to reduce the high level of indebtedness but also provide for new equity to be raised from outside sources. By encouraging companies to go public and list, banks can get a better gauge of the performance of the company based on the liquidity of its shares and market perception. A favourable secondary market performance of a company's shares can influence the credit evaluation of the same very firm by its banker.

ECCB could also consider providing incentives to banks that are successful in encouraging their corporate clients diversify their capital base.

Indigenous banks also serving as intermediaries in the ECSM market can establish syndicate relationships among themselves to develop and promote financial instruments engineered for the corporates within the region. This would also help to provide some competition to the Trinidadian and Barbados merchant banks that are aggressive in the region. Some of our indigenous banks are developing competencies in the investment-banking arena, and the same ought to be encouraged.

Secondary Market for Distressed Debt:

Somewhat related to the above-mentioned item, development of secondary market in distressed OECS corporate debt would support the restructuring process in several ways: a) it would help troubled banks to dispose-off poorly performing loans and therefore enable more efficient management of loan portfolios, b) it would create a process for signalling the market valuation of troubled loans, and c) it would allow prospective acquirers to accumulate a strategic equity interest in corporations or real estate projects and to exert influence over the restructuring. Development of a structured secondary market in loans would increase liquidity and persuade borrowers, banks and other market participants of the merits of realising values by disposing of assets. Several measures can foster the development of a secondary market for debt in the region: a) standardisation and simplification of the sale agreement for loans, b) establishment of standard settlement procedures, c) establishment of codes of practice for market activity, and d) establishment

of mechanisms for transparent valuation of loans. Such measures would bring greater transparency and efficiency, improve liquidity and encourage more companies to trade their debt in the secondary market.

Listing of Corporate Debt of Private Companies within the ECCU

Some private companies within the ECCU have shown their reluctance to stage an Initial Public Offering (IPO). Existing substantial shareholders are reluctant to give up control of the company in which they currently have a significant influence. There is a perception that a by-product of issuing- and listing- equity is that there will be a consequential loss of control. A preferred option for some of these private companies might be to list debt instruments. The Securities Act and ECSE listing rules would have to be reviewed for changes to allow for the same to happen.

Listing of Off Shore Companies

A number of off shore companies have been registered within the ECCU. Some of these companies may wish to have their securities listed on a reputable securities exchange. A scrutinised effort will be needed in conjunction with the governments to ensure that there is a proper basis and framework for selecting from such companies to list on the ECSE. The same may not be deemed as allowable under the existing body of legislation within the countries. If such an option is feasible, the legal/regulatory basis for doing so could be further studied.

Asset Backed Securities

Promoting securitization and other innovative mechanisms to allow for risk pooling and the creation of liquid instruments is very important, especially in the case of emerging markets where there is a critical need to create liquidity in the banking system. The benefits of securitization in the United States, brought about through the likes of Fannie Mae, has not only provided for increased liquidity, but also created instruments for various profiles of investors that have included: a) mutual and pension funds, b) state and local governments, c) foreign investors, d) individuals, e) commercial banks, f) insurance companies, g) savings institutions, h) and corporations.

Securitization can be used to sell performing and impaired assets and holds great promise for banks in the OECS region seeking to dispose of assets. However, certain prerequisites will be needed to undertake securitization, namely: a) legal environment, b) transparent accounting environment, c) regulatory environment, d) taxation environment, and e) back-office systems. The same will have to be dealt with while developing a securitization program.

OECS commercial banks, as originators of mortgages and quality loans, could sell/pass these assets to an institution that will be responsible for repackaging the securities (the arranger). The securities would then be underwritten by brokerage firms and re-offered to the public via the ECSE. Eastern Caribbean Home Mortgage Bank (ECHMB) set up with the mandate to arrange and serve as underwriter for home mortgages should play an increasingly large role and replace Trinidadian (and other institutions) serving as

arrangers for such a type of transaction. Commercial Banks could also undertake similar roles for other forms of assets such as personal loans, car loans and account receivables.

Cross Listings

The present ECSM market infrastructure and legislation does not allow for companies from outside the OECS to cross-list on the ECSE. The same is critical to increase the number of listings as well as provide the liquidity needed for the market to develop. Such an effort will require closer co-operation between the ECSE and the ECSRC.

Facilitate the Development of the Regional Government Securities Market (GSM)

As indicated earlier, OECS countries are facing high borrowing costs arising out of their existing arrangements with Trinidad and Tobago financial institutions that are assisting in the issuance and placement of government-sponsored securities. A regionally integrated market with uniform placement and auction procedures is critical to ensure guarantee of such securities at more attractive terms.

Further, the need to develop bond markets to complement the role of banking institutions in financing long-term projects is of the utmost strategic importance. The development of domestic bond markets needs to evolve in a systematic fashion. The key ingredient for a buoyant corporate bond market is a well functioning market for government debt. A strong government bond market provides an ideal learning ground to achieve pricing and trading skills without the distraction of credit risk. Market based benchmark rates for medium and long-term securities facilitate more accurate pricing and contribute to the development of a deep bond market. Further, it allows market microstructure issues such as trading practices, registry, transfer and settlement, accounting and other similar issues to be established on firm ground. It is essential that liquidity and transparency be established for the government bond market.

The ECCB and the ECSE have made significant progress in this area. The ECCB has put together a cohesive program for the successful implementation of a regional market for primary issuance of government securities. The ECSE has built a sophisticated platform for auctioning, registering and settlement of securities in the primary market as well as an avenue for secondary trading of such instruments as well. The same was undertaken based on the recommendations of the Regional Debt Co-ordination Committee comprising financial sector officials from all the 8 countries. Host country governments need to show urgency in adapting to this new regimen as its success will lead to better pricing and placement of securities by issuing governments as well as ensuring future success of the corporate bond market in the region.

Developing a Diversified Base of Institutions to Participate in the Allocation and Mobilisation of Capital

Developing Institutional Investors – The Case of the ECUT

One of the fundamental questions is whether retail investors should be encouraged to directly participate in the primary market (the usual situation in developing economies) or indirectly through institutional investors. In the U.S., empirical evidence points to the

fact that over 85 percent of the allocation in new issues is allocated to institutional investors. Due to lack of operating history or market prices, there is considerable uncertainty regarding future prospects of new issues. In developed markets, institutional investors provide screening services. They use their expertise, knowledge, market contacts and private information to more accurately assess the prospects of firms going public. Their large positions provide them with considerable bargaining power to get involved in the corporate governance and force management to focus on value maximizing strategies in the post-issue phase. As a result, issues attracting strong institutional demand generally perform in the post-issue phase and add to market depth. Issues that attract weak institutional demand either withdraw from the market or target individual investors who are at an informational disadvantage.

It is critical that the establishment of the proposed Eastern Caribbean Unit Trust (ECUT) within the OECS region is facilitated for the above-mentioned reasons. More importantly, it will provide a basis for less sophisticated investors within the OECS to participate indirectly in the ECSM through the acquisition of units of such a vehicle. ECCB, in its money and capital markets development initiatives, has always been aware of the need to ensure that all of the peoples of the region benefit from the opportunities unlocked by the markets. It is recognised that, in order to ensure viable markets; the needs of both the institutional and individual investors are addressed. In the new market environment, the institutional and larger individual investor is satisfactorily accommodated with the broker-dealer arrangements that are in place. The small investor, however, with lower levels of investment funds may find these benefits harder to derive. In order to address this, a regional investment vehicle, such as the ECUT, is critical for the region.

In general, the ECUT will allow the smaller investor to acquire an interest in a large pool of assets, which would normally be unavailable, given the size of their investment funds. It would provide a greater degree of diversification to reduce the risks inherent in investments. The benefits of the pooling arrangements and the professional management of the trust should also result in higher returns that might otherwise be possible.

Unleashing Restrictions Placed on Social Security Schemes/National Insurance Schemes
A uniform policy and code of conduct for investment departments of these institutions needs to be implemented on a region wide basis. Such institutions should be allowed to have an increased portion of their fund accumulations placed in securities markets, in addition to bank deposits and government securities-which are some of the only investment choices available at this time. The basis for establishing portfolio limits should be undertaken by a committee comprising of market and investment professionals drawn from the region and elsewhere. These schemes should also be allowed to invest freely within the OECS region-notably in companies listed on the ECSE. Investments in foreign securities should be gradually phased in based on the maturity of the investment management industry and the availability of instruments, or lack thereof, in the domestic market.

Social security schemes currently holding shares of enterprises should be allowed to freely trade them to enable better asset-liability management-especially as it relates to maximization of returns for beneficiaries.

A regional regulator responsible for monitoring and overseeing the conduct of social security/national insurance scheme arrangements would be useful for the region.

Establishment of Investment Clubs in the Region

The concept of investment clubs could play a very positive role in the development of a securities market and an educated base of investors. An investment club is nothing more than a small group of individuals, usually comprised of friends, church members, neighbours and family members, who meet on a regular basis for the purpose of pooling and investing in a club portfolio. While these clubs are certainly interested in profit, members also find that investment clubs provide an opportunity to learn about investing. Usually, investment clubs are organised as partnerships and, after the members study different investments, the group decides to buy or sell based on a majority vote of the members. Efforts could be made to incentivize the creation of such entities in each of the 8 countries.

Exploring New Opportunities for DFIs: Regulatory and Operational Changes

Regulation of DFIs as part of the standard banking sector supervision in host-country banking systems is an important step forward towards formalising prudential financial requirements of DFIs and allowing for standardising their information disclosure.

The above-mentioned changes in regulatory safeguards would also permit DFIs to eventually become more independently funded (e.g. through own bond issues), by attracting market investors who rely on standardised disclosure reports, which would provide comparable information for making investment decisions. In this respect, the example of DFIs in India, Philippines, and Trinidad and Tobago (which issue their own bonds to fund development projects), would be an interesting successful model that we would like to see being further explored in the OECS context.

DFIs would want to consider the possibility of investing in “hard” as well as “soft” infrastructure of securities markets. “Soft” infrastructure involves funding the establishment and institutional development of market intermediaries- broker-dealers, investment funds, etc., and “hard” infrastructure relates to funding the development of market infrastructure, namely: clearing and settlement systems; depositories to facilitate dematerialization of securities, capable registrars to improve the safe custody and administration; and trading systems that ensure a transparent price discovery mechanism, and a liquid secondary market. These areas could serve as profitable opportunities for DFIs in the long run.

A number of countries have considered the possibility of allowing DFIs to serve as “window agencies” for brokering securities of corporate issuers (as part of capital market facilitation for investors). This should be carefully studied for application in the OECS, particularly with the implied operational aspects that might more optimally be shared

with the commercial banking sector. While a DFI might serve as a government sponsored nexus point (or through a collaborative arrangement with the ECSE and/or broker-dealer community) at which to obtain over-the-counter data on securities available for trading, the function of actually transacting trades on the market may be a little more complex. In this respect, it should be considered that for the purchase and sale of securities, most investors, whether individual or institutional, would be more likely to use commercial banking and engage in electronic account debiting in order to purchase securities more expeditiously. Such procedures will be even more invaluable as markets develop in the ECCU region, and efficient real-time transactions are demanded to ensure investor confidence.

If DFIs were to perform these functions, they would be required to open deposit accounts (and thus be supervised under the Uniform Banking Act), which could lead to growth in an area of business that they are not presently set up for (in terms of risk management of assets and liabilities). While cash transactions could be possible, these proceeds would need to be eventually transmitted electronically to the recipient of funds, which again would depend on a commercial banking communications network. Also, for safety reasons, the carrying of cash by customers would not be desirable, particularly if purchases of securities were of very large amounts.

Independent **credit rating** agencies that evaluate and monitor outstanding credit risks, and provide for critical information are absolutely critical as the region's markets move towards a level of maturity. A number of DFIs in emerging markets have taken the lead to sponsor the creation of such agencies. The Industrial Development Bank of India (IDBI) has been instrumental in supporting the creation of one of the 3 ratings agencies that exist in India. The other 2 agencies have also been supported by other Indian DFIs. This will soon become a missing link in the market, and the potential of having DFIs in the OECS take the lead in this area will have to be studied.

New Opportunities for Diversification for Credit Unions

Some of the new areas for diversification in securities markets for DFIs mentioned above, could also be explored for relevancy to the credit union industry. More detailed analysis is needed prior to making concrete recommendations for this industry.

Exploring the Basis for Forming Real Estate Investment Trusts (REITs)

REITs are companies dedicated to owning and, in most cases, operating pools of income producing real estate, such as apartments, shopping centres, offices and warehouses. Some REITs are also engaged in financing real estate. REITs mobilise debt and equity in the capital markets and thereby create a direct link between real estate valuations and the cost of capital. The prospects for setting up REITs in some of the countries of the OECS where development of real estate will be key to the future, is something worth an examination by governments.

Reduction of Flight of Capital from Home Markets to Developed Securities Markets

There are a significant number of entities and individuals openly soliciting investments from our regional population in securities from outside the OECS region. This is resulting in large amounts of capital being siphoned away to promote the growth and development of enterprises outside the region. While the same is difficult to control, it becomes all the more important for us to increase the availability of regional financial instruments to our investing population-so that domestic capital can foster the growth and development of the region's very own enterprises.

To compound this problem, a number of the investment opportunities are being offered to the public by entities and individuals from Trinidad and Tobago, Barbados and the United States without a proper license. The Securities Act of 2001 expressly states that anyone engaged in securities business within the region needs to obtain a license prior to performing such a business activity. This practice needs to be regulated and the Securities Act enforced to ensure that such unlawful activities are stopped. Moreover, it is critical that those individuals promoting the sale of foreign securities to the OECS population get these registered with the Eastern Caribbean Securities Regulatory Commission.

Development of a Productive Private Sector

Development of Venture Capital Institutions- The Case of the ECEF

The ECSE has created the need as well as opened up an opportunity to attract venture capital to the region. Venture capital now has an exit mechanism through the ECSE. Central to the long-term success of the ECSE is the ability to expand listings beyond the current base of public companies. This will require identifying, financing, and nurturing high growth entrepreneurial firms until they are ready to go public and list on the exchange. Risk aversion and a strong dividend culture among the current investor base in the region are major obstacles to attracting capital to high risk, start-up firms. The existing investor base is likely to migrate towards established firms in the region that have a strong track record of dividends. Venture capitalists on the other hand, as a result of high-risk tolerance, desire for above average returns and expertise in nurturing start-up firms that are ideally suited to the task of financing and developing entrepreneurial firms. Another advantage of venture capital backing is that their involvement in firms going public provides some measure of certification that the issuer is adequately financed and well positioned to compete as a public corporation. Credible certification will be especially important in nascent markets such as the ECSE to serve as a protection against investments in marginal, inadequately prepared firms trying to go public in an attempt to capitalize on investor optimism. Poor post-issue performance can lead to investor disillusionment and adversely affect liquidity and trading volume.

The region is likely to also generate demand for the European form of venture capital, i.e., buyout or acquisition financing. With the establishment of the regional securities market infrastructure, existing public companies will be exposed to the entirely new experience of market monitoring. The performance of the public company both relative

to its past and compared to its industry peers is likely to be closely followed by analysts, institutional investors and other market participants. Firms that do not meet benchmark performance targets are likely to face tougher scrutiny from the investing community. Even mature, established firms would be under pressure to restructure, cut costs, upgrade technology, expand aggressively through acquisitions, and invest in new economy related lines of businesses. Firms with insufficient borrowing capacity or depressed stock prices could find it difficult to obtain financing on reasonable terms in the public debt or equity markets. These firms will increasingly have to turn to private equity in the form of buyout, turnaround or acquisition financing. As a result, venture funds that cater to late stage or mature firms are likely to be in demand.

ECCB's proposed Eastern Caribbean Enterprise Fund (ECEP) initiative will serve as a regional investment/venture capital fund, which will access domestic and international capital for private sector development. The Fund will act as a vehicle to source funds regionally and internationally and direct these resources to promoting the development of private enterprise in the currency union in order to stimulate economic growth and employment in the productive sectors.

It is proposed that the ECEP would provide both equity and loan capital, directly or indirectly through other institutions, for all aspects of private sector enterprise development. Resources would be directed to the most productive areas that are identified as being consistent with the economic development strategies of Member States. The fund would also focus on the critical area of entrepreneurship development, including training initiatives, business advisory services, and other areas of technical assistance and support. One of the objectives would be to nurture new and existing companies in order to facilitate their graduation to a public listing on the ECSE.

The ECEP is conceptualised as an omnibus financing vehicle that will collaborate with existing regional and national institutions to promote the development of enterprise in the currency union. The full participation of the domestic institutions, including the commercial banks and other nonblank financial institutions, in providing capital resources is also anticipated.

The ECEP would include in its charter and objectives the factors that will govern the basis for investing in growth-oriented enterprises and entrepreneurial sectors across the ECCU region. Certain sectors targeted for growth and investment will serve as the priority areas for investment by the ECEP. Emphasis on investment will be placed on companies with a true regional focus. For e.g., firms with a multi-destination tourism and multi-country production orientation/mindset would be good prospects for investment by ECEP.

Establishment of a Regional Chamber of Commerce and Industry

An effort has been initiated to establish an OECS Chamber of Commerce and Industry. The same needs to be expedited, as it will allow a more regional representation of business interests. Consolidation is likely to be the name of the game in most of the industries within the OECS, and it is for this reason that a regional chamber may be in a

better position to influence change in the government-private sector relationships within the region.

Establishment of a Regional Accounting and Auditing Association

The success of the domestic capital market is largely dependent on the adoption of internationally recognizable financial standards and codes of good practice. There is a need to establish a regional association that encourages companies to comply with quality accounting standards (accuracy, relevance, transparency, comprehensiveness, timeliness) and international conventions. This body could also set auditing standards and mechanisms as well as take the lead in the promotion of corporate governance mechanisms. Such an association could be set up as a Self-Regulatory Organisation (SRO) falling under the regulatory purview of the Eastern Caribbean Securities Regulatory Commission (ECSRC).

Need for Inflow of Foreign Savings through Portfolio Investment Inflows

A primary source for infusion of capital into the productive enterprises as well as in the secondary market will come from foreign institutional investors seeking diversification. Bell-weather firms that form part of the ECSE index will benefit from such investors pursuing index investing. Availability of institutional capital for companies could also reduce cost of corporate borrowing.

Governments will need to relax alien-shareholding requirements and taxes related to purchase and sale of securities to allow for free movement of portfolio investments into the region. Foreign institutional investor participation will be key to increased liquidity and transparency in the ECSM.

Non-OECS nationals are presently not allowed to freely participate (alien shareholding restrictions apply) in the buying and selling of securities in the ECSM market. As part of the region's commitment to adhere to the requirements of WTO protocols and those within CARICOM, the same will have to be reviewed. Participation by investors from the broader Caribbean and elsewhere will have to be phased in to comply with these requirements.

Supportive Legal and Regulatory Structure

Towards a Unified Approach to Supervision

The complexity of global markets, the increasing rate of change within industries and the growth of financial conglomerates has placed an enormous strain on systems with multiple and overlapping regulatory and supervisory structures. In assessing the effectiveness of current regulations and supervision it is often noted that the distinctions between different types of financial service providers have blurred. Common concerns about market stability have led to a greater degree of international discussion about two methods for enhancing it: supervision of market participants and imposition of market discipline. International organizations have recently developed minimum standards for supervision of financial intermediaries and for timely accurate disclosure of material

information by market participants. At the same time, individual countries recognize that supervisory programs should apply equally to all intermediaries and across all industry segments, thereby increasing the interest in the concept of a "super-regulator". **Super Regulator** is a term that describes a recent trend in financial sector supervision where all or some supervisory agencies of various financial sectors (e.g., banking, insurance, capital markets, non-banks, and/or social security/pension) are combined into a single legal entity. Super Regulators are generally formed to make the supervisory process more efficient and to provide enhanced proactive, consolidated supervision.

Not all countries have the political will or desire to create a "super-regulator" entity and can take other steps to obtain its advantages. First and foremost, they can work on improving cooperation between regulators. This relates to shared use of information provided by systemic analyses to detect risks that may cross over regulatory boundaries. There needs to be shared use of information about financial conglomerates so that an effective strategy for supervising all of their financial activities can be developed. And most importantly, there must be an understanding of how the regulatory entities will function when risks are identified. Who will take the lead? What are the timing requirements for action? What is the planned supervisory action?

The basis for a unified supervisory action over all the financial market institutions in the ECCU needs to be closely studied. There are a number of institutions that may presently fall out of the purview of a pro-active effective regulatory structure. No matter what alternative structure is used, the pressures to enhance regulatory and supervisory frameworks to deal with the integration of financial markets will continue with the changing financial sector paradigm in the region. The international financial institutions have already recognized this trend and thus the convergence of standards across various industries, even if the regulatory bodies applying them remain separate. Whichever way the region decides to go, will depend on the specifics. These specifics will dictate the speed and complexity of the enhancements needed to prevailing regulatory structures.

Removal of Legal Impediments

Host-country governments will need to harmonize pieces of relevant legislation to that of the Securities Act. This will need to be done soon so as to eliminate any disparities in the interpretation of the Securities Act vis-à-vis other relevant Acts such as the Companies Act and Alien-Shareholding Acts prevailing in each of the 8 jurisdictions.

Exemption of Transfer- and other Related taxes

The ECSE is designed to operate as a regional market within the ECCU. To support this initiative, member governments of the ECCU will need to continue providing exemptions to OECS nationals from all taxes related to the purchase of securities traded on the ECSE, as well as to waive the alien land holding licence requirements. For OECS nationals "owning a piece of the rock", will no longer simply mean acquiring real estate in the investor's domestic domain, but will now also embrace ownership of financial assets (equity and debt) from across the entire Eastern Caribbean region. Further, the same concession will need to be granted to investors from outside the region to allow for increased depth and liquidity in the market. Further, taxes on capital gains, dividends

and withholdings for OECS investors would need to stay completely removed. Moreover, favourable tax treatment for all investors will be key to the overall success of the securities market in the region.

Licensing and Registration of Outside Individuals/Entities and Foreign Financial Products

As noted earlier, individuals engaged in the securities business and promoting the sale of products (from outside the ECCU) in our regional market would need to attain a proper license from the ECSRC. It is also critical that those individuals promoting the sale of foreign securities to the OECS population get these registered with the Eastern Caribbean Securities Regulatory Commission (ECSRC).

Legal and Regulatory Basis for Restructuring Distressed Companies

A sound legal and regulatory basis for restructuring distressed companies will need to be put in place within the region. This would include: a) legal protection in the bankruptcy law for creditors and an ability to impose losses on debtors, b) removal of tax, legal and regulatory impediments to corporate restructuring, c) framework to support out-of-court corporate restructuring efforts and d) sufficient human capacity to undertake the process of restructuring.

Comprehensive Marketing, Education and Awareness Program to Support Such an Initiative

One of the major problems confronting the OECS region is the lack of awareness among certain sections of the population as to what is really taking place in the financial sector. While the ECCB and the ECSE have been embarking upon a comprehensive marketing, education and awareness program, the same is not enough. Further, costs for rollout of such programs is exorbitant. Dedicated commitment will need to be made by host-country governments to make available free airtime as well as share in the costs of promoting the new financial sector institutional arrangements and opportunities for all affected parties. A comprehensive effort that includes the activities of the ECSE, GSM, ECUT, ECEF and other related institutions would need to be addressed jointly using a combination of communication tools.

Such a program will have to be two-fold. The first aspect of the program would be targeted at the general populace while the second aspect of the program would focus on intermediaries, companies and active institutional/retail investors.