

III Money and Capital Market Development Initiatives

The goal of the *money and capital markets development initiatives* being sponsored by the ECCB is to create a “single financial space” within the Eastern Caribbean region. This is seen as the fulfillment of the objective set in Article 4, Section 3 of the ECCB Agreement requiring the Bank to “promote credit and exchange conditions and a sound financial structure conducive to . . . balanced growth and development.” The program seeks to achieve greater economies of scale in the region’s financial operations by integrating the regions’ financial markets. It also aims to broaden and deepen the financial markets and to enhance the effectiveness and efficiency of the mobilization of domestic and foreign savings to foster economic growth.

The ECCB perceives its role to be that of a catalyst to establish the needed financial institutions and markets and, at the outset, the Bank plans to assume an active role as market maker and a key player in the operation of these markets. The ECCB is determined to safeguard the fiscal and monetary discipline imposed by its quasi-currency board arrangement, and plans to divest equity participation in the new and proposed financial institutions (discussed below) once successfully launched.

Each element of the money and capital markets development program is designed to fill a particular niche in the financial sector:

- The *money market program* has two components. The first is the development of a fully integrated market for government short-term paper (the treasury bills market), in the form of a fully integrated primary and secondary *Regional Government Securities Market* (RGSM). Technical assistance for the RGSM was provided by the IMF in 1996 and 1997, and the ECCB is working with the member governments on getting operations started. The second is the establishment of a private money market (in negotiable certificates of deposit and other short-term private instruments). There has been little progress on this front, and not much is expected before the establishment of the call exchange (see below).

- The *capital market program* includes the *Eastern Caribbean Home Mortgage Bank* which provides a secondary market for residential mortgages; the establishment, within the next two years, of the *Eastern Caribbean Enterprise Fund*; the creation of an *Eastern Caribbean Securities Exchange* intended to provide a regional secondary market for shares (equities) and promote secondary trading of these securities; establishment of the *Eastern Caribbean Securities Regulatory Commission*, along with the supporting legal and regulatory framework that will provide for the regulation of the securities market; and the creation of an *Eastern Caribbean Unit Trust Company (ECUTC)*, a regional mutual fund investment company designed to facilitate the participation of small investors.

The RGSM program is being designed to develop, expand, and integrate the existing markets for the region’s government securities (currently largely comprised of the issuance of three-month treasury bills by five of the eight ECCB member governments), thereby broadening the range of portfolio investment alternatives available to investors within the region. The program seeks to redress market segmentation that has limited the demand for government securities. The successful establishment of the government securities market is the vehicle chosen to bring about greater flexibility of interest rates in the region, driven by market determination of the yield on government securities (see Chapter V). It is expected that this will provide governments with enlarged access to domestic sources of financing as a more cost-effective alternative to borrowing from commercial banks, particularly in the longer end of the market. Furthermore, long-term government bonds would broaden the range of investment alternatives for long-term savings generated by the region’s pension funds and insurance companies.

While planning for the implementation of the RGSM, the ECCB has aimed to lay the groundwork for an integrated market by increasing its role

in managing government bond issues, administering member government sinking funds, providing advice on the terms and conditions of bond issues, facilitating payment of interest coupons via local commercial banks, announcing bond issues, and disseminating prospectuses and the relevant application forms. The Bank has also launched a publicity campaign to help promote acceptance of the RGSM program among potential investors. In addition, a *Regional Debt Coordinating Committee* comprising the Directors of Finance/Financial Secretaries of the member territories, has been appointed to regulate and help develop the RGSM.

While certain decisions have already been taken, for example, that the auctions will be uniform price auctions and that participation will be restricted initially to residents of the OECS states only, there are several organizational issues and supporting measures still to be addressed. Some of them are the need for uniform tax treatment of residents and non-residents of the ECCB area, agreement on arrangements for ensuring the availability of funds during the transition period in the event that some issues are undersubscribed, and various computerization and software-related issues.

Since its inception in 1995, the *Eastern Caribbean Home Mortgage Bank* (ECHMB) has helped mobilize liquidity for private sector investment by providing primary lenders (such as commercial banks, credit unions, building and loan associations, and development banks) with access to liquidity in exchange for the sale of their primary mortgages. The ECHMB, in addition, has expanded its scope of operations by making arrangements with some primary lenders who offer mortgages on its behalf. At end-January 2000, ECHMB's portfolio of mortgages amounted to EC\$ 22.8 million.

The ECHMB has had six successful bond issues, including a bond for mortgages swap. Most of the bonds were subscribed by institutional investors and individuals in the member territories, as well as investors from Barbados. Bond issues outstanding as of end-1999 amounted to EC\$56.1 million. ECHMB bonds provide investors with an investment alternative to commercial bank deposits. The institution has shown a steady growth in profitability. Its borrowing costs have been relatively low—the interest rate paid on the outstanding bonds issued ranges from 6.75–7.75 percent, while the benchmark lending rate is approximately 10.25 percent. The latter is still below most rates on the primary market, as the ECHMB has been able to pass on the savings from its low cost of funds and low overhead costs (owing to the wholesale nature of its operations) to its customers in the form of lower mortgage rates. Member governments of the ECCB area have awarded ECHMB bonds tax ex-

empt status, thereby increasing the advantages of these instruments.

The *Eastern Caribbean Enterprise Fund* (ECEEF), still in the planning stage, is intended as a sub-regional investment/venture capital fund, that would raise domestic capital for private sector development as well as help organize and channel foreign investment capital from two existing regional investment funds—the Commonwealth Equity Fund (CEF) and the Caribbean Investment Fund (CIF)—and other international sources to viable private sector initiatives. The ECEEF would provide venture capital in the form of debt and equity financing (both indirectly, through equity participation in financial institutions and other funds, and through direct equity participation in business firms) to private enterprises with primarily an export- or import-substituting focus. In so doing, it would try to manage risk by maintaining a portfolio balanced in relation to geographical origin and industrial orientation, new versus established enterprises, maturity structure of assets and liabilities, foreign exchange exposure (through judicious use of forward exchange rate cover), and debt versus equity investments.

The ECEEF is not expected to start for some time. For the time being, the ECCB has decided to maintain, and focus on, the *Export Credit Guarantee Scheme* (ECGS), which has been in operation since 1984 (but with interruptions). The ECGS provides partial (up to 80 percent) guarantees at a 1 percent charge for short-term (up to 180 days) commercial bank credits intended to provide pre- and post-shipment working capital for export firms. Some consideration is now being given to expanding the scheme's coverage to include a domestic production credit facility. The latter is being supported under the Multilateral Investment Facility of the Inter-American Development Bank (IDB). The ECCB has allocated EC\$1 million toward the capitalization of such a fund, and the credit guarantees can be issued up to 20 times the capital base. The present contingent liability of the Export Credit Guarantee Scheme is EC\$5 million. The ECGS was restructured within the last year, and now falls under the jurisdiction of the ECCB's Financial and Enterprise Development Unit (FEDU), which is charged with monitoring its performance. As part of these reforms, commercial banks are now bound by a credit ceiling of EC\$100,000 and are required to consult with FEDU before using the scheme, as well as report to FEDU by the day after the transaction and submit monthly reports thereafter.

The *Eastern Caribbean Securities Exchange* (ECSE) is envisaged as the first regional electronic stock exchange in the Western Hemisphere. Funding for the ECSE project has been obtained from the IDB (via the CDB), and the project is scheduled to

be completed in 2000. Implementation will, however, require the elimination of a number of legal impediments, including the passage of uniform securities legislation in the member territories. Two subsidiary institutions of the ECSE will be created to provide electronic clearance, settlement, registration and custody of securities listed on the ECSE. They are the *Eastern Caribbean Central Securities Depository (ECCSD)* to provide clearance and settlement, as well as custody services, for intermediaries and custodian banks; and the *Eastern Caribbean Central Securities Registry (ECCSR)* to maintain the registers of securities holders on behalf of issuers and to provide a range of registry services.

These prospective money and capital markets initiatives would require the passage, by governments of member states, of important enabling legislative and regulatory reforms to cover tax harmonization; the Aliens Landholding Laws; Uniform Securities, Insurance, and Development Banks Laws; uniform accounting, reporting, and disclosure standards; and the harmonization and eventual elimination of various capital account restrictions.

The efficiency of the RGSM is likely to be constrained by the extensive differences in taxation policy across countries (both in terms of types and rates of taxation as well as the nature of exemptions granted), which is likely to impinge on the relative attractiveness of member countries' securities. The ECCB's Legal Unit has therefore recommended the harmonization of taxes on dividends and interest, and on profits and capital gains (as well as stamp duties). The St. Lucia model is upheld as an example to consider since it exempts nationals of member states from withholding requirements on tax on dividends, interest or discounts, leases, premiums, licenses, annuities, or other periodic payments. Although tax reform is not a prerequisite for starting the RGSM, until taxation policy is harmonized, differential tax treatment will have an important bearing on the operations of the market.

Alien landholding regulations restrict the holding of land by unlicensed aliens²⁷ and the holding of an interest in companies under alien control that are incorporated in any member state of the OECS in order to promote the establishment of locally owned companies. The legislation also imposes restrictions on trusts in favor of aliens. The administrative requirements for the issue, transfer, and maintenance of a license are cumbersome and may delay the processing of applications by investors. This has direct implications for the viability of the proposed Securities Exchange and the RGSM. A proposed draft Aliens Landholding Regulation Act would modify the existing Acts by changing the definition of the word "alien" so that only noncitizens of OECS member states would be considered alien. However, so far, the draft bill has not been approved by the legislatures. As an alternative, the ECCB has asked the member countries to consider exempting citizens of OECS member states from the provisions of the Act on a reciprocal basis.

A *Harmonized Companies Act* has been enacted by all member countries except St. Kitts and Nevis, where a similar act was already in force, and contains modern provisions governing the formation, registration, operations, and closure of companies. The Harmonized Companies Regulations, intended to facilitate the administration of the Companies Act, also have been approved by all member countries (except St. Kitts and Nevis). The regulations provide for standard forms to be presented to the Registrar of Companies; set out the fees for services provided in accordance with the Act, such as registration, the issuance of certificates, and searches; and require the filing of annual returns. The regulations also standardize the content of prospectuses, reports, financial statements, and the general by-laws of a company incorporated or continued under the Act.

²⁷"Alien" is defined as any person who is not a citizen of that territory and companies owned by noncitizens.