Driving Growth via The Securities Market

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OPENING

The Hon. Andrew Holness, Prime Minister of Jamaica,

the Hon. Audley Shaw, Minister of Finance,

Marlene Street-Forrest, Managing Director, the Jamaica Stock Exchange,

Specially invited guests, fellow speakers, industry and NCB colleagues…ladies and gentlemen good evening.

It's a pleasure to be here in the capacities of CEO of NCB Capital Markets and that of President of the local securities industry lobby group, the Jamaica Securities Dealers Association (JSDA).

NCB Capital Markets, is proud to be, once again, the lead local sponsor of the annual JSE conference. The conference is a staple in the calendar, not just locally, but regionally and as such in addition to sponsoring this year, we have committed to being the lead local sponsor for the next two years.

Tonight I want to touch on a topic that is very dear to me and my industry colleagues; and that is the role of the market maker in the capital markets and its impact on the economy.

The reality is that in Jamaica, and I am sure many other Caribbean countries, the market making mandate of securities dealers tends to be underestimated and its role in driving economic growth not understood or fully appreciated.

ROLE AS MARKET MAKER FOR GOJ INSTRUMENTS

Within the Jamaican context, securities dealers gained prominence in the 1990s at a time when the GOJ had an insatiable appetite for financing after a protracted period of large fiscal deficits. It was the new kids on the block, the securities dealers, which filled the gap between the investors with appetite for short term assets and the government that needed longer term funding.

As such, when there was a primary market issue, the dealer would take a position in this long term instrument and financed it with shorter term funding from repo investors. All parties were happy, the government, got its financing, the investor got a decent rate of return and the dealer got a spread for taking the gapping risk.

On the secondary market, when supply of said instrument out-stripped demand or vice versa, the dealer would create liquidity by buying or selling from its own inventory by moving around its client repo funding. Again, all parties were happy, the buyer and seller would get a transaction done smoothly, the dealer gets a margin, and this assurance of liquidity for GOJ securities, made it easy for the GOJ to continuously tap market.

This insatiable appetite for funds was not sustainable and we know what happened. We ended up with an IMF programme, which included two debt exchanges which caused broker dealers billions of dollars in capital and number of structural reforms. Though the changes were painful for the industry, we survived and continue to survive.

Now imagine taking that very same model, and applying it to corporate and infrastructural based securities. Think of a situation whereby securities dealers act as intermediaries for corporates structures to drive economic growth. The very same model that filled the GOJ treasury could be used to drive the needs of productive entities and projects to grow the economy.

After all, the capital market is an attractive alternative to traditional bank financing as terms tend to be more flexible to the borrower and in many instances cheaper, when a traditional banking solution is less appropriate.

So the GOJ has been asking for lower interest rates and more flexible financing terms for businesses…well here is the opportunity. However, there exist significant limitations due to regulatory hurdles, many of which have been imposed in recent times.

LIMITATIONS

The Financial Services Commission (FSC), in keeping with the commitments made by the GOJ under the Extended Fund Facility approved by the IMF, implemented reforms to the securities dealers sector aimed at improving investor protection and enhancing the long-term systemic viability of the securities industry.

Using the language of the dealer community, the reforms were pretty much designed to kill the repo product and replace it with off balance sheet products such as unit trust and mutual funds. The reforms included significant tightening of prudential standards which reduced the attractiveness of repos as a product for both dealers and investors.

This along with currency related restrictions and two debt exchanges significantly hampered the securities dealers' ability to perform its market maker role; a function that served the GOJ well during its time of need. A function that is not the mandate of a collective investment scheme, a bank or any other financial institution. The changes are many but I am going to focus on three to get my point across.

a) **Allowable Assets**

   The pool of allowable assets that a securities dealer can invest in excludes foreign currency denominated securities issued by local companies.

   The current framework allows investment in foreign governments and corporates that are rated investment grade, but does not allow the same foreign currency to flow to local companies engaged in productive enterprise.

Since banks are able to offer foreign currency denominated loans to these companies, there is no material impact on the foreign currency market by this omission. If companies have foreign currency funding needs they will need to get bank funding, with possibly less favourable terms and less flexibility. This measure only reduces competition and restricts access to various types of funding options required to support business growth.

b) 100% credit risk weighting for US$ GOJ securities

Among the slew of capital charges implemented on securities dealers, there is the 100% credit risk weighting for US$ GOJ instruments. This weighting is equivalent to the risk weighting for private equity exposure under current risk weighting standards. Private equity is riskiest asset class that one could contemplate.

This level is inappropriate and inconsistent with international practice. Debt instruments of a sovereign are generally considered to be zero risk to 20% risk weights, with adjustments for a market risk component at times.

Jamaica's experience has been such that debt restructures have taken place twice on Jamaica dollar denominated debt, yet these securities are 0% weighted while the global bonds have 100% risk weight applied. Additionally, the market outlook, credit ratings and economic fundamentals for GOJ issued global bonds has significantly improved over the last few years.

A reduction in risk weighting would release capital that could be redirected to providing further financing solutions to local corporates and infrastructural projects.

c) Exempt Distributions

Local entities seeking to issue US$ instruments exceeding US$35M within a year and securities dealers seeking to raise even a dollar have to seek exemption from the Minister of Finance, upon recommendation by the central bank, sighting section 22 of the Bank of Jamaica Act.

Interestingly, Jamaica has no restrictions on foreign currency movements in and out of the country. Therefore any corporate that has a need to deploy hard currency, will be forced to convert anyway as opposed to tap into existing USD liquidity…resulting in pressure on the foreign exchange market.

Secondly, this rule has negative implications for the pricing of US$ funding as the capital markets would not be able to effectively compete with the traditional less-flexible financing solutions.

Thirdly, investors that really want hard assets, will just simply move their funds overseas if there is scarcity of quality local assets to invest in, creating a bigger problem which is capital flight.

DEPTH AND BREADTH OF THE CAPITAL MARKETS

Historically, many, including market players, have questioned the breadth and depth of the local capital markets that is, its capacity to absorb large complex transactions. Then came 2017, which saw swell in the size, number and complexity of transactions done in Jamaica. During that period…

i) We saw $105B worth of private placements issued under the FSC's Exempt Distribution regime, up ~ 24% relative to prior year.
ii) Of that amount three of those represented the largest JMD registrations ever in Jamaica…ranging from $10B to $18B each.
iii) One institution, through a series of debt issues, raised close to $46B locally to prepare for what will go down as one of the largest, if not largest, regional acquisitions for this decade.

Not to be outdone, in public space we saw

i) 16 securities listings, among that was a $18B corporate bond listing via Introduction… a record in recent years
ii) the two largest IPOs ever in the history of Jamaica. One being Productive Business Solution …. Then there is the recently closed Wisynco IPO which raised $6.1B … attracting close to $18.8B, bringing in 8000 plus new shareholders to its company and 2000 plus new equity investors to the market
iii) The JSE is on track to have its 100th listed on the exchange this year having closed 2017 with 96..

Now ladies and gentlemen with the opportunities we see, if we agree that a well-functioning capital market can result in lower interest rates, especially in certain funding segments and we agree that certain regulatory obstacles exist that the government has control over, then it so follows that one of the biggest impediment to lower interest rates and access to efficient financing is the government itself.

The traditional types of financing, alone, can't take us to where we need to be as country if we want to achieve the 5% economic growth aspiration by 2020 - the initiative dubbed 5 in 4. What 2017 has shown us ladies and gentlemen, is that the local capital markets stand ready to be an engine of growth through the provision of flexible financing solutions and that if regulatory hurdles were to be removed, the impact on the economy would be transformative.

RECENT REGULATORY CHANGE AND IMPACT

I want to comment on a recent regulatory change which is very encouraging and I want to really commend the FSC for pushing this through.

The change involves the expansion of the pool securities used as collateral for retail repos. The change, though it may appear simple, will significantly impact the market making capacity of securities dealers.

The expansion allows for a larger group of corporates to better access the debt capital through dealer intermediation with the use of repo funding.

Additionally, securities issued by companies owned and agencies of GOJ are now included. This will create greater appetite and better terms for funding GOJ led infrastructural projects as well as allow for the GOJ to improve its debt ratios through the removal of explicit guarantees as dealers are now better able to

execute its market making mandate with these securities, which would otherwise require a GOJ guarantee to be funded via client repos. I hope this move is an indication of greater levels of collaboration between the FSC and securities industry.

CLOSING

In closing, I want to throw a challenge to the Government. Let's, this year, remove the obstacles to the efficient functioning of our capital markets.

Let's allow the capital markets to play its part, an integral part, in us achieving the 5 in 4 economic growth aspiration.

Let's make Jamaica, and by extension the regional capital markets, the poster child for capital markets led economic transformation among developing countries

Minister Shaw, why settle for being the Father of junior stock market? It is an accolade well deserved for his role in the development and protection of the junior market. But why not set an aspiration to be the Father of Jamaica's modern-day capital markets? The industry stands ready to work with government and all stakeholders to make this a reality.

Ladies and gentlemen, thanks for the continued interest in the JSE conference and by extension the development of the regional capital markets. I look forward to seeing you later at the NCB Capital Markets hosted cocktails as well as an informative and productive next 2 days.

Thank you