



# *THE REGION GOVERNMENT SECURITIES MARKET- RGSM*

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## **ABOUT THE ECCU'S REGIONAL GOVERNMENT SECURITIES MARKET**

### **THE MARKET**

The Regional Government Securities Market, the RGSM, is the focal point for buying and selling treasury bills, notes and bonds issued by the governments of the currency union, that is the Governments of Anguilla, Antigua and Barbuda, Dominica, Grenada, Montserrat, St Kitts and Nevis, St Lucia and St Vincent and The Grenadines.

It allows investors to choose from the pool of financial instruments offered by the eight ECCU member governments, under a common set of standards and rules. This centralised platform will lead not only to more efficient and effective operations, through harmonized rules, regulations and standards, but also to the elimination of taxes on the purchase of government securities for all nationals of the ECCU.

### **BUYING AND SELLING GOVERNMENT SECURITIES**

Investors wishing to trade on the Regional Government Securities Market do so through licensed intermediary firms known as limited service brokers and broker dealers. A [directory of licensed intermediaries operating within the](#)

[ECSM](#) can help you to locate licensed broker dealers and limited service brokers.

Trading on the Regional Government Securities Market takes place through an auction system, using the platform and mechanism of the [Eastern Caribbean Securities Exchange](#). Articles on "[Trading Government Securities on the RGSM](#)" will serve as a good starting point for prospective investors to understand the operations of the market.

#### LEGAL AND REGULATORY FRAMEWORK

The Regional Government Securities Market is regulated by the [Eastern Caribbean Securities Act](#). All eight countries participating in the market have passed the Act, which sets out the laws under which the market must operate. In keeping with the Securities Act, [the Eastern Caribbean Securities Regulatory Commission \(ECSRC\)](#), has been set up to ensure that the market operates safely and soundly.

The Eastern Caribbean Securities Regulatory Commission requires that before going to market for every primary issue, each government must submit a prospectus, disclosing specific information to the market.

Having listed securities on the Eastern Caribbean Securities Exchange, governments are required to present quarterly updates on the economic and financial performance of their country. This is so that investors can have access to the information required for making informed decisions. [Click here to access articles on "Market Regulation and Investor Protection"](#)

### **Regional Debt Co-ordinating Committee**

A Regional Debt- Co-ordinating Committee, the RDCC, comprised of Financial Secretaries and Finance Directors from each of the eight governments has been set up to ensure that the market operates efficiently, within the context of harmonised objectives, policies, procedures and rules. The RDCC is responsible for ensuring that the Governments comply with established disclosure requirements.

### **Eastern Caribbean Central Bank**

The [Eastern Caribbean Central Bank](#) performs the role of fiscal agent to the participating governments. The Bank advises the governments as to the most appropriate instruments to issue, within the context of sound debt management policies, and the most appropriate time to issue securities on the primary market. The Central Bank will also undertake some of the administrative duties associated with the issue. **However, each government is responsible for guaranteeing the instruments it issues.**

? [Objectives and Functionalities of the RGSM](#)

- ? [Investing in Stocks and Bonds](#)
- ? [Trading Government Securities in the Primary Market](#)
- ? [Trading Government Securities in the Secondary Market](#)
- ? [The Benefits and Risks of Investing in Government Securities](#)

#### THE OBJECTIVES AND FUNCTIONALITIES OF THE REGIONAL GOVERNMENT SECURITIES MARKET (- RGSM)

The basic objective for the Regional Government Securities Market (RGSM) development initiative is the establishment of a fully functional and efficient regional market to meet the financing needs of the Member Governments of the Currency Union as they pursue their development objectives.

Prior to the development of the Regional Government Securities Markets, the markets for government securities in Member States were characterised as rudimentary and segmented with little or no cross-border participation. They were largely primary markets, with limited opportunity for secondary trading beyond the ECCB-operated secondary Treasury Bill Market, accessible only to clearing banks. Because rates were fixed rather than market determined, they did not reflect any elements of risk.

The RGSM was established to integrate these fragmented markets into a single regional market, to facilitate cross-border operations and secondary trading of government securities. The removal of the existing impediments is expected to result in a change in the holder base, which is currently comprised mainly of institutional investors.

As the market develops the prices for government bills and bonds should become more aligned to the concept of liquidity risk, purchasing power, and the opportunity costs of funds. This should eventually result in the provision of information about various interest rates to allow for classification of the varying types of investments, and determination of the appropriate opportunity cost of funds in the region. Both Government and corporate issuers will be able to use this information to determine what types of investment to make and what vehicles or instruments would be best suited to their needs.

The ECCB acts as Fiscal Agent to the RGSM. As Fiscal Agent, the ECCB advises governments participating in the RGSM on the type, timing and terms and conditions for the issuance of securities, within the context of sound debt management policies. The ECCB also undertakes administrative duties associated with the issuance of securities on the ECSE. However, each Government is fully responsible for the securities that it issues.

Providing oversight to the RGSM is the Regional Debt Coordinating Committee (RDCC). The RDCC is comprised of the head of the Ministry of Finance (Financial Secretaries/Directors of Finance) from each of the eight countries. The RDCC is responsible for formulating rules to direct the conduct of all Member Governments operating in the RGSM. This oversight body has been set up to ensure that the RGSM operates efficiently, and within the context of harmonized policies and procedures.

The RDCC requires that before going to market for each primary issue, Government must provide investors with relevant, timely, accurate and adequate information about the securities that are being issued to the public, as well as information about the issuing Government. These disclosure requirements have

been put in place to ensure that prospective investors have access to the information required for making informed investment decisions.

The prospectus is the principal disclosure document. Each Government must submit a prospectus, disclosing specific information about its fiscal performance. This should include, but is not limited to, the major sources of income and expenditure, budget surpluses or deficits and the size and components of the government's debt.

Participating governments are also required to provide information about their country's economic performance - Factors such as the rate of growth of the country's Gross Domestic Product; the Consumer Price Index; wages and salaries in the main sectors and statistics on the Balance of Payment. Material events such as a recent hurricane, default by an institution of a loan guaranteed by Government, or any event, which could affect the assessment of the security being offered, must also be disclosed.

To ensure market integrity and cohesion and standardization in the regulatory structure of the RGSM, an agreement has been formalised between the RDCC and the Eastern Caribbean Securities Commission. The parties have agreed to collaborate on matters that affect both the licensed intermediaries and government securities, and the agreement is intended to enhance the effectiveness of execution of the respective roles of the RDCC and the ECSRC.

General terms of the agreement include:

? oversight of the primary issuance of securities on the Regional Government Securities Market;

- ? cooperation in the regulation of licensed intermediaries where government securities may be affected; and
- ? ongoing supervision of the RGSM with particular regard to informational exchange, compliance with established rules and regulations and consultations prior to making changes to legislation or rules that may affect government securities.

The RGSM leverages the ECSM infrastructure. The Eastern Caribbean Securities Exchange (ECSE) and its subsidiaries facilitate the issuance, clearance and settlement as well as registration of the Governments' securities. The secondary trading of these securities is also facilitated on the ECSE.

The Governments have undertaken to establish the necessary institutional and operational mechanisms within the Ministries of Finance. This includes the establishment of a Debt Unit with appropriate institutional capacity to co-ordinate government's debt contraction process, to develop debt strategies, and to provide timely and sound advice to the policy makers, and timely and accurate information to the market.

A properly functioning RGSM will serve as the catalyst to deepen the Currency Union's financial markets and facilitate their integration by removing national boundaries. The operations of the RGSM are expected to result in improvements in the flow of capital and liquidity across the Currency Union which should lead to enhanced funding possibilities for Governments at lower cost, and to increased savings and investment opportunities for the private sector, to facilitate economic growth.

## INVESTING IN STOCKS, BONDS AND TREASURY BILLS

Shares, or stocks are securities that represent ownership in a company; so when you buy a share you become part owner of the company. When the company does well, you receive a portion of its profits. But if the company experiences financial difficulty, you also share in its losses.

There are two (2) types of shares, (i) ordinary shares also called common shares, and (ii) preferred shares. Common shares give the shareholder a vote in the selection of directors, and a proportionate but unspecified claim on the company's profits. These profits may be distributed to shareholders as dividends declared by the company's directors from time to time, and paid out as either cash or additional shares. Since profits will vary as a business thrives or declines, so too will dividend payments. In fact a company might not pay dividends in years in which it made little or no profit.

Preferred shareholders are entitled to certain preferences not enjoyed by holders of common shares. Preferred shares entitle their owners to receive a fixed dividend and to be the first to receive a share of the company's profits. And, if the company is liquidated, preferred shareholders will be paid before the holders of common shares. However, they do not have voting rights.

Unlike shares, which represent equity ownership in a company, treasury bills commonly referred to as T-bills and bonds are debt instruments. These represent loans to the issuer. We can think of bonds as long-term loans and T-bills as short-term loans. While both companies and governments issue bonds, only governments issue T-bills.

Treasury Bills are issued with a term of one year or less; so a government may issue a 91 or a 181-day treasury bill, any period that is less than or equal to one

year. The buyer of a T-bill, that is the investor, lends money to the government for a specified time. At maturity, that is when repayment of the loan is due, the government will repay the investor the full value of the bill, called the face value.

Treasury bills are usually sold at a discount that is at less than the face value. But because the investor is repaid at the face value, the investor will receive more money than was actually paid for the T-bill. The difference between the purchase price of the Treasury bill and the amount repaid at maturity represents the interest or the return on the investment. Let us look at an example.

An investor purchases a 91-day T-bill with a face value of \$10,000 for \$9,500. The investor therefore purchased the Tbill at a discount, having paid \$500 less than the face value of the Treasury Bill. When the T-bill matures, the investor will be repaid not at the discounted price of \$9,500 but at the face value of the bill which is \$10,000, a gain of EC\$500.00. This \$500.00 represents the interest earned by the investor.

Bonds, on the other hand, are long-term loans to companies and governments. When a company needs money to develop a new product or build a new plant, or a government needs money to pay, for example, infrastructure development, they may decide to issue bonds. The issuer, that is the company or the government, sets the terms of the bond including the interest rate and the time when the bond will be repaid. Therefore, the investor who buys the bond lends money to the company or government for a set term, at a specific interest rate. The interest is the investor's return on his investment.

The duration is an important determinant of the interest on the bond. Because the price of a debt security moves opposite to interest rate movements, the longer the duration, the greater the possibility that the price of the bond will be affected by

market fluctuations, for example, inflation. So, a 30-year bond price is likely to fluctuate more than a 5-year bond because the interest rate is locked in for a longer period. This we call interest rate risk, one of the risks associated with bonds. Because Treasury Bills are short-term instruments they tend to be less vulnerable to interest rate risk fluctuations than bonds.

Another risk – credit risk, that is the possibility that the borrower will not be able to repay the loan, is associated with both bills and bonds. An issuer's debt service record may provide a good indication as to the level of credit risk associated with its existing or future securities.

There is a concept of risk and return that states that the higher the risk the greater is the expected return on an investment. The logic is that the seller of a high-risk security should compensate the buyer for assuming a higher risk probability relative to other similar investments.

A broker dealer can assist investors in understanding and evaluating these and other investment related risks. Understanding the risks attached to each security will help each investor to purchase the securities best suited to his/her needs.

#### PURCHASING GOVERNMENT SECURITIES IN THE PRIMARY MARKET

Whenever we speak about newly issued securities, we are focusing on the primary market. The word primary means first and so it follows that when securities are

sold for the first time, these issues of securities take place in the primary market. This differs from the secondary market where existing owners sell already issued securities to another investor. For example, if you purchase an EC\$10,000 thirty-year bond which is being issued by a particular Government, you have purchased this bond on the primary market. If five (5) years later you decide to sell the bond, the sale will take place in the secondary market.

Announcements about upcoming issues of bonds and bills on the RGSM are publicised in regional newspapers, and on radio and television. Broker dealers and limited service brokers also receive information about impending issues of government securities, which is also posted on the website of the Eastern Caribbean Securities Exchange Ltd at [www.ecseonline.com](http://www.ecseonline.com)

All persons wishing to invest in the RGSM must do so with assistance from a licensed financial intermediary. The benefit of this arrangement is that the financial intermediaries can provide access to all of the government securities available on the RGSM.

Before purchasing any security all investors should read the related prospectus very carefully. They should take advantage of the knowledge and investment analysis that broker dealers can provide. The financial professionals employed by broker dealers have the training and expertise to assist in understanding the

information written in the prospectus and in determining which investments are best suited for individual needs. It is important to note the difference between brokers and broker dealers. Only broker dealers and not brokers are licensed to provide investment advice. However both brokers and broker dealers are licensed to purchase and sell securities in the market on behalf of investors.

The minimum purchase amount for any government security issued in the RGSM is EC\$5,000 and incremental units of EC\$1,000 thereafter. Investors place their orders to purchase the securities at the offices of licensed intermediaries. Written purchase instructions, known as bids placed with the intermediary are submitted by them electronically to the market.

Before the broker dealer can submit the investor's bid to the auction, however, the investor will have to provide the broker dealer with funds matching the full value of the bid. The broker dealer will also charge a nominal fee for the investment services provided. The regulations specify that the fees cannot exceed 5% of the overall value of the investment.

Auctions may run for a week or more. Once the auction is closed no additional bids will be accepted. Following the running of the auction, electronic communications identifying the successful bids will be sent to the respective intermediaries. Investors who were not successful will receive a refund from the

intermediary, in accordance with previously agreed instructions. Successful investors will receive a confirmation notice from the intermediary indicating the quantity and price at which the securities were purchased.

On the day following the auction, the Eastern Caribbean Securities Exchange Ltd will announce to the public the final price or prices of each auction. Settlement, which is the point at which the buyer receives the ownership of the security and the seller receives the money for the securities sold, will also take place on the day following the auction (T+1).

Once settlement occurs, the intermediary will arrange for the registration of ownership of the securities purchased by the investor. The investor will receive a statement of ownership for the securities purchased.

In addition to the purchase and sale of securities on the intermediary has an obligation to manage investors' accounts and to provide periodic account statements. For purchases of government bonds, the management of the account will include the collection from the issuer of all interest payments related to bonds as well as the principal payment when the bond matures. In the case of treasury bills, the intermediary will collect the principal payments upon maturity. Based on the instructions of the investor, the funds will be transferred to a specified cash account or reinvested, by the intermediary.

Investors holding securities purchased in the regional government securities primary market can later resell the securities in the secondary market, using a similar process.

#### TRADING GOVERNMENT SECURITIES IN THE SECONDARY MARKET

What happens when holders of securities want to sell before the maturity date of their bonds and bills? They go to the secondary market, where, with the assistance of intermediaries, they can buy or sell securities that were previously bought in the primary market. The secondary market is a resale market.

The secondary market is a very important element of the securities market. Investors are more likely to purchase securities in the primary market if they are confident that they can readily convert these securities to cash whenever they wish to do so. The existence of an organised secondary market can provide this level of confidence to holders of securities.

Another benefit of an organised secondary market is that it increases the investment opportunities. Persons who may not have been able to acquire securities on the primary market have additional opportunities to acquire those securities on the secondary market. Of course besides the provision of liquidity, an organised and efficient secondary market is also important in pricing securities. An investor may be able to sell his or her securities at a higher price than the price at which it was purchased based on the value that investors in the market have assigned to the particular security. The appreciation in the price represents a gain for the investor. In investment jargon this gain is known as a capital gain.

But for the secondary market to operate effectively, there must be people willing to sell and others willing to buy, as well as the market infrastructure that provides for the meeting of buyers and sellers. Without an efficient and transparent infrastructure that allows for discovery of price, how will an investor in Grenada, for example, with securities to resell know about an investor in Antigua willing to purchase those securities at a price that satisfies both parties?

These features have been embodied in the design of the Eastern Caribbean Securities Exchange Ltd, the ECSE, which is the focal point for both primary and secondary trading within the Eastern Caribbean Securities Market (ECSM). The electronic trading platform allows brokers and broker dealers to connect directly to the central trading system, and to see all the current prices (buys and sells) for securities that have been placed in the central trading system. Investors wishing to buy or sell securities on the secondary market will instruct their limited service broker or broker dealer to submit an order on their behalf with a stated price requirement. A trade is made when there is a match between the requirements of the seller and buyer.

Trade orders are accepted on the Eastern Caribbean Securities Exchange Ltd each weekday between the hours of 9:00 am to 2:00 pm. The auction is run at 2:30 pm.

In the secondary market, a competitive bidding process based on a single price auction methodology drives the auction. There is no guarantee that bidders will acquire the security. It is really a case where the best price wins. All of the bids are ranked and a best price is calculated from among of them. All bidders whose prices are above or equal to this best price will be awarded securities at the calculated best price. But there is no guarantee that all bidders will acquire the security they are interested in.

Purchasing government securities in the secondary market is similar to the process applied to the primary market. Investors must contract the services of an intermediary (either a limited service broker or a broker dealer), and place their orders to buy or sell at a specified price. Before placing the order the intermediary should let the investor view a live display of the trading system on the computer screens. The screen will show the best available prices at that point in time for each security submitted on behalf of investors to the Exchange.

This information can provide a basis for deciding on the price at which the investor's order should be placed. Because orders are accepted up to 2:00 pm. the investor can modify the initial instructions to the broker dealer up until this cut-off time. As the day progresses and more orders are submitted to the Exchange, the best price may also change. An investor may decide to modify his or her order in an attempt to increase the probability that the order placed will be at or above the best price when the auction is run.

It is worth mentioning that each buying investor must first transfer to his/her broker or broker dealer firm, monies amounting to the full value of the proposed purchase. And each selling investor must authorise the transfer of the required amount of securities to his/her broker or broker dealer firms before an order can be placed on the investor's behalf. This principle ensures against any potential risk of default by either party.

The day following the auction, the Eastern Caribbean Securities Exchange Ltd will announce to the public the final price of the auction.

Settlement, which is the point at which the buyer receives the ownership of the security, and the seller receives the money for the securities sold, will occur on the day following the auction.

Once settlement occurs, the intermediary will arrange, as per instructions provided by the investor, for the registration of ownership of the securities in the case of a buying investor or the collection and security of the funds in the case of a selling investor.

#### THE BENEFITS AND RISKS OF INVESTING IN GOVERNMENT SECURITIES

Investing is the art of balancing risk and return, so just as with any other security, there are risks associated with government securities. Two (2) possible risks are, (i) interest rate and (ii) credit risks.

Credit risk is the risk that the issuer of the security, in this case a government, will not be able to meet its obligation to the holders of its securities. Investors can take into consideration the government's history of payments, which can give an indication of the level of credit risk associated with its existing or future securities. In addition the information in the prospectus on the financial and economic position of the government should also give an indication as to the level of credit risk associated with its securities.

Interest rate risk is the risk that interest rates may rise and hence create a decrease in the value of the price of the security. Simply put the price of a debt security moves in the opposite direction to the movements of interest rates. If interest rates increase the price at which a debt security trades will decrease. The reverse is also applicable.

In accordance with the concept of risk and return, the higher the risk the greater the expected return on an investment. The logic is that the seller of the high-risk security should compensate the buyer for purchasing a security that has a higher risk probability relative to other similar investments.

Government securities usually offer higher rates of return than regular savings accounts or fixed deposits. It might therefore be prudent to include them in the portfolio mix. By diversifying your portfolio you can reduce the level of risk.

Very often it is difficult to find the money to do the things we need to do – pay educational expenses, buy a home, cover medical emergencies, name it. One solution to this problem could be to invest in each of the three (3) main types of Government securities. Because they each mature at different periods, they can be selected to meet specific needs. Bonds and notes, for example, provide long-term savings options and are ideal instruments for saving towards a new home, retirement or the children's education.

Treasury bills, on the other hand, which mature within a year are better suited for savings towards short-term goals, for example the well-deserved vacation, or a down payment on a mortgage. In developing an investment portfolio it is necessary to maintain a mix of long-term and short-term investments that will mature to coincide with specific needs. This will also provide protection to the portfolio from excessive exposure to one dramatic market condition at any given time.

Notwithstanding the best planning in the world, investors sometimes need to encash a security before maturity. The instrument can be sold on the secondary market. Investors in the RGSM can invest in securities offered by any of the eight (8) participating Governments.

Information about the Government Securities Market and the instruments being offered is readily available from licensed intermediaries, Treasury and Finance Departments of participating countries as well as from the ECCB, ECSE and participating Government websites.

