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**ACTION PLANS
FOR DEVELOPMENT
OF THE USAID/JAMAICA'S
FINANCIAL MARKETS DEVELOPMENT
COMPONENT OF THE EXPORT DEVELOPMENT
AND INVESTMENT PROMOTION PROJECT**

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ACRONYMS AND DEFINITIONS OF TERMS USED

Acronyms:

- CFA Program** The Institute of Chartered Financial Analysts is an autonomous professional self-regulatory organization composed of members, called Chartered Financial Analysts, who are engaged in the practice of financial analysis, who have completed a widely recognized three-year sequential correspondence study and examination program, and who subscribe to high standards of practice. The Institute is a subsidiary of the Association for Investment Management and Research (AIMR), an organization made up of the Institute of Chartered Financial Analysts (ICFA), the Financial Analysts Federation (FAF) and the Research Foundation of the ICFA-organizations sharing similar objectives in the professionalization of the practice of financial analysis.
- COSRA** The Council of Securities Regulators of the Americas.
- IISMD** International Institute for Securities Market Development. The IISMD is sponsored by the U.S. Securities and Exchange Commission. It hosts a two-week program in Washington, D.C., every March/April. An optional two-week internship after the program is also offered.
- IOSCO** The International Organization of Securities Commissions.
- JSE** The Jamaica Stock Exchange.
- JSE Rules** The Rules of the Jamaica Stock Exchange. The Rules cover every aspect of the Exchange's governance, admission to membership, listing, trading, settlement, financial, and operational responsibility and discipline.
- SC** The Securities Commission.

Definitions:

Automated Surveillance System — A computer-based surveillance system that performs Stock Watch Tracking functions and subsequent match-ups of buyers and sellers involved in unusual market movements.

Call-over — An Exchange trading floor system in which trading in listed shares is conducted sequentially on a company-by-company basis within a prescribed maximum interval of time.

Capital Formation — Increases in productive resources such as plant and equipment. Also known as investment.

Capital Market — In general, the market for equity and debt instruments with a maturity of over one year.

Central Securities Depository (CSD) — A CSD provides trade clearance and settlement and depository functions. The CSD owns the securities in trust for the beneficial owners thereby permitting processing of transactions in "book entry" form. Ownership is transferred from one account to another through debits or credits on the CSD's books.

Clearance — The processing of transactions in securities in which the buyer's and seller's records of a transaction are matched in preparation for settlement.

Continuous Auction — An exchange trading floor system whereby all listed companies can be traded throughout a market's entire trading session.

Financial Instruments — Shares, Debentures Rights, etc.; in general, securities.

Front Running — A broker trading prior to executing a client's order in the same security.

Insider Trading — An insider taking advantage of price-sensitive information that has not been disseminated.

Investment — See Capital Formation.

Liquidity — The characteristic of a market (or of a listed security) with enough potential buyers and sellers to allow large transactions without a substantial change in the prevailing price.

Market Capitalization of an Exchange — The summation of the market capitalization of each listed company; market capitalization of a company is the number of shares in issue multiplied by their market price.

Member Firm — A member (in corporate form) of the JSE. No individual memberships are allowed.

Post Trade Automation System (PTA) — A PTA system refers to automating/computerizing the clearance and settlement procedures which must take place after a trade is agreed on the exchange floor. A PTA system may include a CSD, market information systems, trade processing, surveillance and management information modules.

Price Earnings Ratio — The market price of a share of stock divided by its earnings per share.

Primary Market — The market in which new securities are issued to original investors.

Ramping — Market manipulation to artificially raise or lower the price of a security in advance of a large transaction.

Regulator — A statutory body charged with the responsibility for regulating the securities markets. Typically, this is accomplished by oversight regulation of a licensed Self-Regulatory Organization (SRO), the Stock Exchange, which oversees the market it operates and the member firms participating in those markets. The Regulator (the SC) approves (or disallows) the SRO's rules and regulations.

Secondary Market — The market in which already issued securities are bought and sold among investors.

Securities — Shares, Debentures, Rights, etc.

Self-Regulatory Organization (SRO) — A securities-industry private member-owned and operated stock exchange that oversees the market it operates and the member firms participating in this market.

Settlement — Payment to the seller and delivery of stock certificates (or other means of transferring ownership) to the buyer.

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INTRODUCTION

Increases in a country's investment in productive resources, capital formation and attendant job creation, result in economic growth. The financing of that investment can be provided by internally (domestic) or externally (foreign) mobilized savings. A country's capital market, the market for medium- and long-term funds, is the mechanism whereby domestic savings are channeled into investment. Capital consists of both debt and equity financing. In the discussion that follows, the focus is principally on equity financing, but similar comments would be applicable for debt financing also.

When a company issues securities in the capital market and receives the proceeds of the sale, that transaction is termed a primary issue. Primary issues relate directly to capital formation. In contrast, secondary issues or secondary market transactions are sales or transfers of existing securities from, for example, an existing shareholder to a new purchaser(s) in which the selling shareholder receives the proceeds of the sale.

Technically, primary issues are arranged outside of a stock exchange, although immediate listing and exchange trading of the newly issued securities may be an integral part of the capital raising process. Trades of securities on a stock exchange (exchange trading) are secondary market transactions; that is, the securities being sold have already been issued in a primary market transaction, such as an initial public offering or a rights offering. In an initial public offering, a group of investors or the investing public purchases newly issued securities, usually through a subscription agreement. These shares may then be listed and traded on an exchange. In a rights offering, existing shareholders are offered the right to subscribe for additional shares being issued in proportion to their existing holdings.

The primary market creates the supply of securities to be traded on the secondary market. The secondary market can provide the liquidity — the ability to convert a security into cash — necessary to attract investors to the primary market. Typically, investors are reluctant to purchase securities that cannot be sold. This is particularly the case with equity securities, where there is no maturity date when the investor will receive his/her principal, as in the case of a debt security.

In contrast with the market for tangibles such as real estate, in which the principles of *caveat emptor* (let the buyer beware) applies, the market for securities optimally is based on fair and orderly trading markets and the principle of full disclosure of all material facts necessary for an investor to make an informed investment decision. Such principles lead to liquid markets, with broad investor participation, and enhance the primary market's function of mobilizing savings and translating these into investment.

The role of a securities market regulator (hereafter, the Regulator) is to enforce a country's securities laws that should be designed to result in fair and credible securities markets. In this way, the Regulator plays a key role in establishing or maintaining the integrity of the market for securities and the consequent beneficial effects on capital formation, employment generation, and economic growth. In Jamaica, the Securities Act of 1993 that creates the Regulator (the Securities Commission) has been enacted but is not yet effective, and the Securities Commission (SC) as an institution is not yet in existence, although the Commissioners have been appointed by the Minister of Finance.

As the regulatory process has evolved, the optimal regulatory structure is for the Regulator to exercise oversight regulation of a Self-Regulatory Organization (SRO); namely, the Stock Exchange. The Stock Exchange should be organized to directly supervise its members and is the only organization that can perform this task efficiently. However, the Stock Exchange typically is owned by its member firms, and the establishment and enforcement of the rules of the Stock Exchange can be thwarted by the self-interest of the member firms despite the best efforts of the Stock Exchange staff. Securities laws (including

Jamaica's Securities Act) normally require the Regulator to be satisfied with the rules of an Exchange and that the Exchange is effectively enforcing compliance by member firms with its rules. If the Exchange is unable to achieve compliance, it can request the Regulator to intervene, and, if necessary, the Regulator has the statutory right to directly regulate the market and its participants.

The existence of a Regulator/SRO structure to regulate the markets has a positive effect on attracting foreign portfolio investment. Foreign portfolio investors seek well-organized and regulated emerging markets. Even more important in this regard is an efficient clearance and settlement system for securities transactions. Clearance is the processing of securities transactions in which the buyer's and seller's records of a transaction are matched in preparation for settlement. Settlement is the payment to the seller and delivery of securities or other means of transferring ownership to the buyer. Under the Securities Act of 1993, the Regulator must be satisfied with the clearance and settlement arrangements of the Jamaica Stock Exchange (JSE) in order to issue it a license allowing it to continue operation.

The establishment of an efficient capital market becomes of vital economic importance as an economy transits from public sector domination to being private sector-led. Without an efficient capital market, a private sector-oriented economy will not be able to tap savings, and capital formation will be curtailed. Further, the privatization efforts of the government will be constrained both in initial privatizations in which portions of Government Enterprises are sold to the public and subsequently as these enterprises need expansion capital.

The recent history of activity on the JSE has mirrored the undesirable pattern exhibited by a number of emerging markets: As a previously repressed economy begins to experience economic liberalization measures, the nascent or previously stunted stock market experiences a level of activity and price increases that are unsustainable from a market infrastructure vantage point — particularly the clearance and settlement of securities — and from a valuation vantage point. Subsequently, the market falls and a period of building of an appropriate foundation begins. This should include a modernization program for the exchange and the establishment of a statutory regulator to oversee the self-regulatory efforts of the exchange over its members.

* In Jamaica, during 1991 and 1992, the stock index rose by 913.9 percent and peaked in early 1993 at a market capitalization to gross domestic product ratio of over 100 percent. The market capitalization is the sum of the individual market capitalizations of each company on the JSE. An individual company's market capitalization is the number of its shares in issue multiplied by the market price. Particularly for an emerging market, a market capitalization to gross domestic product ratio of over 100 percent represents a speculative and unsustainable bubble. As a reference point, the average market capitalization to gross domestic product ratio for the developed markets (as classified by IFC's *Emerging Stock Markets Fact Book*) was 60.2 percent and 19.4 percent for emerging markets in 1991, the latest figures available.

A further reflection of the same phenomenon was the excessively high price earning ratios (the market price per share divided by earnings per share) in the face of a high interest rate environment. The growth rate in earnings (and ultimately dividends) required to justify a given intrinsic or investment value (in contrast to market price) rises as the level of interest rates rise. Hence, a high level of interest rates at a given growth rate in earnings/dividends should be associated with low price earning ratios reflecting the lower present value of the future dividend stream.

In early 1993, the market peaked and has exhibited an orderly correction of some 50 percent to date. While factors in addition to the rise in interest rates played a part in this decline, the rise in interest rates helped correct a speculative market atmosphere that was getting out of control. It is fortunate for the

future development of the market that this speculative emphasis was reined in at this time as the inevitable correction would have been more severe otherwise.

However, a potentially more serious situation has arisen with respect to the clearance and settlement of securities transactions. It is estimated by the JSE that it takes up to six months for a trade to settle due to inherent delays related to the paperwork processing associated with a number of aspects of the post trade processing (after a trade has been agreed on the exchange trading floor) including, but not limited to, delays in registration of the new owners' names and obtaining transfer tax exemptions. To permit subsequent trading in shares where the settlement process is not complete (that is, the securities have not been delivered to the new owner and his/her name does not appear in the share ownership records maintained by the registrar), the registrar issues a certification that the seller is the owner of the shares being traded. This is cumbersome and involves high systemic risk stemming from 1) company notifications, dividends, and rights offerings will not be sent to the correct owners; and 2) if the original certification of ownership is invalid, all subsequent trades related to that certification will automatically fail to be completed creating a cascade effect.

Another fundamental problem associated with the current status of the JSE as an SRO without oversight regulation by a statutory body is that the JSE may not be able to enforce compliance by its members with its own rules or institute other rules that may be necessary. Both of these types of situations were described as ongoing problems for the Exchange Management.

A lesser problem confronting the JSE is the trading method being utilized, a "call-over" system, which allocates a fixed maximum interval of time within which all trades in a given security must be concluded. Thus, trading in certain securities subject to high volume may not be able to be completed within the specified interval.

Apart from issues concerning the SC and the JSE, three supervisory agencies were investigated in less depth: The Bank of Jamaica (BOJ), the Superintendency of Insurance Companies, and the Superintendency of Unit Trusts.

While the scope of work focused on the BOJ's needs with respect to open market operations, both the Governor and the Deputy Governor, Banking Operations Division, cited more pressing and unattended problems in the area of Bank Supervision; namely, monitoring, internal management assessment, and the establishment of an early warning system. There has also been a proliferation of near banks and Building Societies that are outside the purview of the Central Bank but that are owned by banks and thus could represent a threat to the stability of the banking system.

The Superintendencies of Insurance Companies and Unit Trusts are under one official, whose resources are stretched to the limit in terms of staff and lack of equipment. The problem areas here are 1) a total lack of regulation of the pension fund management activities of the Life Insurance Companies, which involves an estimated total investment of approximately J\$6.5 billion and 250,000 pensioners; 2) the lack of human and equipment resources necessary to cope with the insurance supervisory reporting requirements; and 3) insufficient regulations and the lack of human resources necessary to properly regulate the portfolio investment activities of the Unit Trusts, which currently consist of five unit trusts comprising an investment of J\$2.0 billion and 50,000 unit holders. The Superintendent believes that an additional 15 unit trusts will be formed in the next 12 months.

SUMMARY RECOMMENDATIONS

The recommendations are listed in order of priority and/or time sequence. Most of the activities can be engaged in simultaneously rather than sequentially.

Task 1. Develop an Action Plan for the Establishment and Operation of a Securities Commission

At present, the Securities Act 1993 has not yet come into effect. As a result, the JSE and its member firms continue to operate without a Regulator. The importance of the capital market to the growth of the economy should call for the planned development of the JSE. The establishment of a Regulator/SRO structure is a necessary step in that development.

From a practical standpoint, the Government of Jamaica has committed itself to putting in place the regulatory framework envisioned in the Securities Act, which, in turn, is part of the World Bank conditionalities to be satisfied by March 31, 1994. Due to the urgency that this time frame imposes, the recommendations are divided into a short-term (six months) and a medium-term (2-3 years) action plan.

Short-Term Action Plan — Six Months (October 1993 - March 1994)

- Funding for the start-up and operation of the SC needs to be arranged with the Ministry of Finance. Subsequent to the consultant's field visit, the Government of Jamaica indicated commitment to support the recurrent costs of the SC.
- Gazette the Act and the Notification of the Members. The Act comes into force upon Gazetting. The Act also requires that the appointment of the Members of the Commission be Notified in the Gazette. The Commission Members have already been appointed by the Minister of Finance.
- Start-up operations of the Commission can commence once Gazetting has occurred. The start-up operations will involve the following activities:
 - Recruitment of core staff: General Manager, Accountant, Administrative Assistant, Legal Officer, and Receptionist/typist.
 - The office space of the Commission will need to be identified and leased. Office equipment and a motor vehicle for the use of the General Manager will need to be purchased. These items have been included in the budget.
 - License dealers, investment advisers, their representatives, and the JSE.
 - Approve a panel of accountants for the Stock Exchange.
 - Approve those Board Members of the Stock Exchange who are not licensed persons.
 - Prepare a register of licensed and registered persons.
 - Develop additional regulations required.
 - As part of the licensing of the JSE, review and approve its plans for a post trade automation system and an automated surveillance mechanism (see pages 9-10 for further details). (A post trade automation system refers to automating/computerizing the clearance and settlement

procedures that must take place after a trade is agreed on the Exchange floor. A post trade automation system may include a Central Securities Depository [CSD], Market Information System, trade processing, surveillance, and management information. A CSD provides trade clearance and settlement and depository functions. The CSD owns the securities in trust for the beneficial owners thereby permitting processing of transactions in "book entry" form. Ownership is transferred from one account to another through debits or credits on the CSD's books. An automated surveillance mechanism refers to computer-based surveillance systems that automatically perform Stock Watch tracking functions. (See page 10 for details.)

- Prepare a submission to the Ministry of Finance with respect to the Commission's position on the taxation of financial instruments, principally company shares, the double taxation of dividends, and the possible removal of stamp tax on securities transactions.
- Commence review of the Companies Act to formally allocate responsibility to the SC for the regulation of issuance as well as trading of securities.
- In order to achieve a rapid start-up, the following technical assistance needs are indicated:
 - Recruitment of General Manager, Accountant, and Legal Officer. For sustainability, the General Manager, at a minimum, should participate in licensing and regulatory technical assistance.
 - Licensing of dealers, investment advisers and the JSE.
 - Development of additional regulations.

The above technical assistance requirements are assumed to be able to be met locally and are included in the revised budget of U.S. \$410,200 (see page 18). Certain additional expatriate technical assistance may be required that is not included in the budget. The additional expatriate technical assistance areas are as follows:

- Compatibility of JSE Rules with the Securities Act and identification of additional regulations required that cannot be met by modifying JSE Rules.
- Review of JSE's post trade automation plans and automated surveillance mechanism.
- Integration of the securities provisions of the Companies Act into amendments to the Securities Act.

The commencement of the above expatriate technical assistance could occur during the short-term plan and is likely to continue into the medium-term plan.

Outputs Anticipated from the Short-Term Action Plan:

- The Securities Act and Notification of the Members Gazetted.
- Core staff recruited, office and office equipment secured.
- The licensing process for dealers, investment advisers, and their representatives on schedule for a completion date, six months from the commencement of the Act (the Gazetting date).

- The licensing process for the JSE on schedule for a completion date, six months from the Gazetting date. Among other things, this implies:
 - Review and approval of JSE's clearance and settlement arrangements.
 - Review and approval of JSE's monitoring of compliance, including the recommended automated surveillance mechanism.
- Identification and drafting of additional regulations.
- Preparation of a register of licensed and registered persons; approval of a panel of accountants for the Stock Exchange; approval of those Board Members of the Stock Exchange who are not licensed persons.
- Compliance with the World Bank conditionalities related to the SC, including a submission to the Ministry of Finance regarding taxation of financial instruments.

Medium-Term Action Plan (2-3 Years)

The Medium-Term Action Plan should be compatible with a master plan for the development of the capital market. Such a master plan would take into account the interrelationships and constraints that may become apparent from an understanding of:¹

- The Macroeconomic Background — the economy and the capital market are interrelated; the focus should be on identifying constraints to the development of the capital market.
- The Institutional Base — namely the institutions that issue or invest in a variety of instruments that will affect the capital market; in particular, the banking system, insurance companies, and pension funds.
- The Supporting Structure — the quality of accounting, legal, and educational attributes of Jamaica.

From an understanding of these areas, the master plan can be formulated as a supply/demand analysis for securities that will identify the constraints and possible incentives to the development of the capital market. Training is usually an essential part of a capital market development plan. The SC is the logical body to lead a working group that should include the JSE in the development and implementation of such a plan.

At a minimum, the activities that should be contemplated during the Medium-Term Action Plan consist of the following:

- Continue to review and monitor the development, installation, and start-up of the JSE post trade automation and automated surveillance mechanism.
- Complete the integration of the securities provisions of the Companies Act into amendments to the Securities Act. Continue development of regulations.

¹ The discussion of a master plan is adapted from an unpublished "Manual for the Development of a Capital Market," by, Sidney Robbins.

- Flesh out the organizational structure of the commission to include a Licensing Officer, an Accounts/Inspection Officer, and an Enforcement Officer.
- Evaluate whether the SC is to become involved with assuring the quality of accounting standards.
- Evaluate the feasibility of further development of the corporate bond market sequential to the Central Bank's work in the secondary market for treasury bills.
- Develop public awareness program to complement JSE publicity.
- Conduct training programs for journalists to improve reporting on financial and business issues relevant to the capital market.
- Develop Advanced Level course on investment in financial instruments — principally company shares.
- Develop training programs for the improvement of professional standards of industry participants. Implement a broker certification program.
- Initiate Chartered Financial Analysts (CFA) program.
- Develop a program of study tours for selected Commission Members and staff — International Institute of Securities Markets Development (IISMD), Washington, D.C., and regional study tours.
- SC to join the International Organization of Securities Commissions (IOSCO) and consider joining the Council of Securities Regulators of the Americas (COSRA) or other relevant regional body.
- Consider hosting a Regional Emerging Markets Conference.

Technical assistance inputs that are likely to be applicable:

- Long-term expatriate advisers to the SC:
 - Capital Market Development Expert and Chief of Party.
 - Securities Lawyer/Regulatory Expert to complete integration of Companies and Securities Acts and continue development of regulations in conjunction with SC legal officer.
- Selected short-term expatriate technical assistance for the following areas:
 - Review and monitoring of JSE post trade automation and automated surveillance mechanism — Stock Exchange automation, clearance, and settlement expert.
 - Assurance of quality of accounting standards — review accounting standards for adherence to internationally accepted accounting standards — international accounting standards expert.
 - Develop public awareness program — public awareness/marketing expert knowledgeable of the securities industry and securities laws.

- Develop Advanced Level course on investment in financial instruments — master teacher trainer expert, plus input on textbook by adviser to SC or outside adviser.
- Train journalists for reporting on financial and business issues.
- Training programs for the improvement of professional standards — focus on training of SC staff and certification program for brokers — experts in the fields of Regulation, Exchange, and Broker Compliance and Broker Training.
- Chartered Financial Analysts Program — experts to liaise with the Association for Investment Management and Research; screen candidates and to provide supplemental instruction.
- Regional Emerging Markets Conference — expert conference coordinator.

Medium-Term Indicators (End of 2-3 Years)

- A functioning SC exercising oversight regulation over an SRO, the JSE.
- An efficient post trade clearance and settlement system installed in the JSE in accordance with international standards.
- Elimination of the backlog of uncompleted trades.
- An automated market surveillance system installed in the JSE with an electronic feed and direct accessing capability to the SC.
- All Broker Dealers, Investment Advisers, and their representatives certified, and training for certification firmly emplaced.
- A specified number of Level I Graduates of the CFA Program and a means for institutionalizing CFA program management and delivery in place.
- Coordinating firmly institutionalized mechanism between Privatization Program and the SC.
- Improvement in the liquidity ratio (the value of shares traded as a percentage of average total market capitalization during a period).
- An increase in the amount of capital raised.
- An increase in the number of listed companies.
- Attendance by Chairman, General Manager, and Legal Officer of the SC at the annual IISMD Program in the course of this period.
- SC membership in IOSCO.

Task 2. Perform an Analysis of Planned Assistance to the Jamaica Stock Exchange on the Mission's Support to the Regulatory Agencies within the Financial Sector and Provide Recommendations to Coordinate Efforts in this Area

Utilizing its own resources, the JSE has contracted with Citibank to undertake the development of a strategic plan to establish automated clearing and depository (the place where securities are located for safekeeping) facilities and to design a securities trading, clearance, and settlement system that conforms to international standards and meets stringent tests of efficiency, low transaction cost, high transparency of transactions, and scripless (no physical certificates) trading. The strategic plan is to be completed over a 15-week period that ends early December 1993. (See Appendix 1.)

The JSE has instructed Citibank to focus first on clearance, settlement and depository and then move on to trading. This sequence is appropriate given the JSE's backlog of uncompleted transactions. However, it should be recognized that the installation of automated clearance and settlement will cure the problem on a going-forward basis only (those trades occurring after the installation). The backlog will remain and will need to be reduced over time.

Once clearance and settlement have been automated, the trading system should be addressed. The current call over system being utilized is inadequate and should be replaced by some form of continuous trading; for example, continuous auction open outcry (conducted on an exchange trading floor utilizing the entire trading session to trade every company's shares) or screen assisted/based (conducted via a network of computer screens in which the exchange trading floor becomes obsolete). For transparency, which is particularly important in an emerging market, a first step to continuous auction on the Exchange trading floor may be more desirable than an immediate move to screen assisted/based trading which has far less transparency. Once efficiencies have been achieved, an intermediate move to screen-assisted trading may be feasible to retain transparency.

The Inter-American Development Bank (IDB) is prepared to consider providing assistance to the JSE in the implementation of its strategic plan. However, the consultant was informed by the IDB's Representative that the IDB's Multilateral Investment Facility (MIF) is specifically designed for technical assistance and not for equipment purchases. Therefore, the IDB's assistance is likely to be limited to funding for computer software, training, and other technical assistance. The funding gap will not be able to be ascertained until the JSE's strategic plan is formulated.

The Securities Act provides the means by which the technical assistance being provided to the JSE can be coordinated with that being provided to the SC. The SC, under the Act, must be satisfied with the JSE's provisions for clearance and settlement and effective monitoring for compliance with its rules and the provisions of the Act.

It is recommended that the Securities Commission require the JSE to include in the strategic plan provision for a CSD that will achieve, on a scheduled basis, the standards developed by the Group of Thirty (G30) and the Fédération Internationale des Bourses de Valeurs (International Federation of Stock Exchanges-FIBV). (See Appendix 2.) These international standards provide an objective measure for the SC to decide whether the JSE's provisions for clearance and settlement are satisfactory. Ideally, the CSD would be an integrated system linking investors, brokers, the exchange, the registrars, and custodian banks through computer terminals. A integrated system could perform the functions of providing Trade Processing and issuance of contract notes, Central Depository, which would include trade clearance, settlement and depository functions (including maintenance of CSD ledger accounts and broker settlement accounts), and Surveillance and Management Information.

In the area of monitoring and enforcement of compliance with the JSE rules and the provisions of the Act, the fact that an automated CSD will be designed and installed provides the opportunity for the JSE to add on a first-class automated surveillance system. The way such a system would work is as follows:

- Each investor (buyer and seller) and broker/dealer would be assigned a unique number in his/her account at the CSD.
- Since each investor and each broker/dealer is known by the CSD, it should be possible to link market manipulations and insider trading to the perpetrators.
- Unusual price or volume movements would be monitored through "Stock Watch" activities of JSE. Commercial software packages are available for this purpose.
- Stock Watch and subsequent CSD match-ups of trades are confidential and would be accessible only to the Market Surveillance Department of the JSE and the Enforcement Officer of the SC via an electronic feed to a computer terminal.

The existence of such a system should have a deterrent effect, which will be beneficial to the integrity of the market. The incremental cost of such a system is expected to be low. It is recommended that the SC request the JSE to include such a system in its strategic plan.

Another area of cooperation/coordination is the role that the SC could play in assisting the JSE with respect to implementing the legal changes to the Companies Act, which will be necessary to permit the CSD to function. The SC is a statutory body and may have better access to the legislative process than a private sector organization.

Jamaica's securities industry, investors, and economy should benefit greatly from an automated CSD of international standards and an automated surveillance system. The establishment of the SC concurrent with the JSE formulating its strategic plan is fortuitous. Coordination between the SC and the JSE together with a viable working relationship are essential for both parties. In this context, the SC must be prepared to actively review the JSE's strategic plan starting in December 1993.

Task 3. Develop an Action Plan for the Reform and Modernization of Three Financial Markets Supervisory Bodies: The Bank of Jamaica, Superintendency of Insurance Companies, and Superintendency of Unit Trusts

The Bank of Jamaica

Both the Governor and the Deputy Governor of the BOJ cited the need for technical assistance in the area of Bank Supervision and the regulation of near banks (e.g., deposit-taking finance companies now covered by the Financial Institutions Act) and Building Societies (equivalent to U.S. Savings and Loan [S&L] Associations).

With respect to Banking Supervision, technical assistance is needed to monitor the banks' loan portfolio quality, to assess their internal management, and to establish an early warning system with regard to the financial condition of banks.

In order to properly train the Banking Supervision Division's personnel, an in-house training program needs to be designed and implemented on an ongoing basis. A further specific need is to establish a regulatory structure for the Building Societies.

The technical assistance requirements listed below should be met by expatriate experts familiar with the U.K. banking system and Bank of England procedures.

- **Banking Supervision Expert** — assist in establishing a monitoring, internal management assessment and early warning system. Design and initially implement an in-house training program for Supervision Personnel.
- **Building Society Expert** — design regulatory structure and assist in its implementation.

Outputs anticipated are as follows:

- A monitoring, internal management assessment and early warning system accepted by the BOJ.
- A regulatory structure accepted by the BOJ.

The Superintendency of Insurance Companies

The expressed need is for technical assistance and equipment support in order to:

- Develop regulations for Life Insurance Company management of pension funds.
- Design supervision and monitoring procedures to enforce compliance with the regulations developed.
- Provide technical assistance on actuarial procedures to be utilized by the Life Insurance Companies.
- Provide data processing equipment, a mainframe computer and terminals, to manage Life Insurance Companies reporting data flows to the Superintendent.

Technical assistance should be provided with respect to developing regulations for pension fund management by an expatriate familiar with U.K. pension fund management regulation.

Technical assistance on actuarial procedures also should be requested to outline the data processing equipment needs to be assessed by an expatriate expert.

The expected outputs are as follows:

- A regulatory structure for the management of pension funds by Life Insurance Companies.
- Actuarial procedures conducted in accordance with internationally accepted practices.
- Appropriate data-processing equipment in place.

The Superintendency of Unit Trusts

The expressed need is for technical assistance to draft additional Unit Trust Act regulations to provide for reasonable diversification and liquidity in the portfolio of Unit Trusts. However, the Superintendent's work load is such that his/her office is unable to evaluate even the existing limited reporting.

Technical assistance should be provided to develop appropriate additional regulations; assess the feasibility of organizing a Unit Trust Association with some features of an SRO; and assess the feasibility of shifting

responsibility for the regulation of Unit Trusts to the SC after it has been established and is functioning. An expatriate expert knowledgeable of the U.K. Unit Trust system would be appropriate.

The intended outputs would be as follows:

- Appropriate additional regulations drafted and accepted by the Superintendent.
- Feasibility determined of establishing a Unit Trust Association with selected SRO features.
- Feasibility determined of shifting regulatory responsibility of Unit Trusts to the SC.

TASK 1. DEVELOP AN ACTION PLAN FOR THE ESTABLISHMENT AND OPERATION OF SECURITIES COMMISSION

A. Short-Term Action Plan — Six Months (October 1993 - March 1994)

1. Gazette the Act and Notification of the Members

Under the terms of the 1993 Securities Act (Act 8 of 1993), the Act shall come into operation on a day to be appointed by the Minister of Finance by a notice published in the *Gazette* (Section 1).

In addition, the appointment of the Commission Members shall be Notified in the *Gazette* (Section 4, Schedule). Presumably, the Notification of the members should be Gazetted at the same time that the Act is Gazetted. The Members already have been appointed by letter from the Ministry of Finance. They are:

- Al Francis — Chairman Head, Department of Economics, University of the West Indies
- Gordon Shirley — School of Management
- Dennis Boothe — Accountant
- Anthony Lewars — Accountant
- Jacqueline Lynch — National Housing Trust
- Dennis Morrison — Attorney

It is recommended that the Act and the appointment of the Members be Gazetted as soon as a Short-Term Action Plan (including funding arrangements) is agreed with the Ministry of Finance, the Securities Commission, and USAID/Jamaica.

The tasks to be accomplished prior to March 31, 1994, as outlined in the Letter of Development Policy, dated May 25, 1993, addressed to the World Bank, call for the following in relation to improving the legal regulatory framework for capital market development:

- Enactment of the Securities Act and creation of a Securities Commission.
- Promulgate Regulations under the Securities Act, including those for the operations of stock exchanges, and establish the Securities Commission.
- The new regulatory framework for stock exchanges will remove existing restrictions on entry/exit and will introduce instead a nondiscretionary entry criteria based on professional qualifications and financial standards, backed up by vigorous prudential regulation.
- The government will also complete a review of taxation of financial instruments including the double taxation of dividends. (The issue of considering the removal of stamp duty on securities transactions should be included in this review.)

It is recommended that the SC be established that it should develop the requisite regulations cited above, to the extent additional regulations are required (see below). The World Bank was contacted on October

1 and confirmed that their concern was for the establishment of an operating commission, not just a law on the books. The sequence of establishing the Commission first and then producing the regulations was not a problem to the World Bank, even though the wording of the conditions implied first drafting regulations.

These tasks, and related issues, are described below with attendant staffing requirements, including short term technical assistance needs, and budget estimates.

2. Commission to develop additional regulations and license dealers, investment advisers, and their representatives and the stock exchange by March 31, 1994

In pursuing its duties under the Act, the SC should bear in mind that a prerequisite to its successful operation is a cooperative working relationship between the SC, the JSE, and its members.

Under the Securities Act (Section 5), the Securities Commission has the following functions:

- “(a) to regulate the securities industry ... and to ensure that appropriate standards of conduct and performance are maintained...;”
- “(b) to consider applications for licenses or registrations...;”
- “(c) to advise the Minister on all such matters relating to the operation of this Act...;”
- “(d) to promote public understanding of the law and practice relating to the securities industry;”
- “(e) to enforce the rules of a recognized stock exchange...;”
- “(f) to perform such other duties as may be provided...”

The Securities Act also calls for the Commission to have accomplished the following within six months (subject to SC approved extension) from the date of Gazetting:

- Create a register of licenses and persons registered for the purpose of the Act.
- Register representatives of Brokers/Dealers and Investment advisers.
- License the Stock Exchange.
- Approve a panel of accountants for the Stock Exchange.
- Approve those Board Members of the Stock Exchange who are not licensed persons.

(Section 78 of the Act is drafted in such a way that it does not contemplate the Commission's refusing to grant a license, although Section 9 gives the Commission such powers.)

In addition, as outlined in the letter of Development Policy, the SC is to promulgate regulations under the Securities Act. The Act specifies the regulations to be promulgated and prefaces them with the wording “The Commission *may* prescribe [emphasis supplied].” As a result, there may be a question as to what regulations the Commission *shall* prescribe.

The Act states that the Commission may prescribe regulations in the following areas:

- Enforcement by the Commission of provisions of the Companies Act re prospectuses (Section 26).
- Margin requirements (Section 42 — the focus here is on the financing of dealer positions rather than the financing of customer positions by dealers, which is the usual thrust).
- Takeovers - Section 50 (already covered in JSE Rules).
- Rules governing the dealing in securities by a dealer who is not a member of a recognized stock exchange (Section 75).
- Regulations pertaining to all facets of dealing in securities and the records relating thereto (Section 76).

A further issue is to examine the link between the provisions of the Securities Act with the JSE Rules (hereafter, the Rules). For example, while there is no prohibition against Insider Trading under the Rules, there is a comprehensive policy statement on timely disclosure of material information. This policy coupled with the Insider Trading provisions of the Securities Act provides an appropriate level of investor protection.

In other areas, the Rules and the Act are similar. For example, the Rules call for the establishment of a Compensation Fund (which already has been created by the JSE and amounts to approximately J\$30 million) while the Act also calls for the establishment of a Compensation Fund. The Rules incorporate a Takeover Code (which is in the process of revision) while the Act states that the Commission may prescribe rules in connection with a takeover.

In those instances where there is a conflict between the Rules and the Act, the Rules should be changed to conform with the Act. Upon the licensing of the Exchange, the Rules of the Exchange become approved by the Commission which has the power to enforce them. Currently, the JSE management may not be able to enforce its Rules on its members.

There is also an overlap between the Securities Act and the Companies Act with respect to which authority, the Commission or the Registrar of Companies, is responsible for regulating the issuance of securities (in contrast to the trading of Securities), although the Securities Act (Section 26) calls for the Securities Commission to enforce the prospectus provisions of the Companies Act, as noted above.

The Companies Act sections that overlap the Securities Act include the following:

39-92	Issuance of Securities
109-117	Register of Members
121-124	Annual Returns
142-156	Accounts and Audit
196	Oppression of Minorities
355-360	Restrictions on sale of shares and offer of shares for sale
Table A	
Third Schedule	
Fifth Schedule	

As part of a Medium-Term Action Plan, the Companies Act and the Securities Act should be modified so that the regulation of both the issuance and trading of securities fall under the responsibility of the Securities Commission.

3. Staffing Requirements, Technical Assistance, and Budget

Based on the near-term workload, consisting principally of licensing and regulatory drafting, and after discussions with the Chairman of the Commission, the immediate staffing requirements are as follows:

<u>Job title</u>	<u>Estimated all-in annual compensation²</u>
General Manager	Up to \$60,000
Legal Officer	Up to 45,000
Accountant	Up to 45,000
Administrative Assistant/Executive Secretary	Up to 25,000
Receptionist/Typist	Up to <u>10,000</u>
Total	<u>\$185,000</u>

The most critical staff that should be recruited first are the General Manager, the Administrative Assistant, and the Accountant. A high-caliber professional staff is being sought, and the above compensation estimates reflect private sector levels.

The General Manager will function as the Executive Officer of the Commission and will report to the Chairman of the Commission. The General Manager will not be a Member of the Commission initially, although at a later stage consideration may be given to recommending the appointment of the General Manager to Membership on the Commission. The General Manager should have broad-based experience (10-12 years) in finance and the capital market. Ideally, he/she would have a masters-level degree in one of the following: finance, management, economics, or law. The Chairman of the Commission has had a detailed job specification and description prepared.

The Administrative Assistant will assist the General Manager in his/her work, with an initial focus on organizing the office and helping to establish relations with the Exchange and the securities industry. A possible candidate has come forward who was previously General Manager/Secretary and Secretary of the Council of the JSE.

The near-term need for an Accountant arises from the fact that the Commission is a statutory corporate body. It will be required to keep proper accounts and other records in relation to its business, including an annual financial statement. The accounts of the Commission will be audited by the Auditor General or an auditor approved by the Auditor General.

The Legal Officer will assist the General Manager in interpreting the Act, in processing the licensing activities, and in drafting of regulations. Ideally, the Legal Officer will have a background in securities law.

Due to the tight time frame within which to staff the Commission, to license the industry participants, and to draft any required regulations, technical assistance will be required from the outset in each of these areas. In order to assure a sustainable Commission, the technical assistance in licensing and regulatory drafting should be performed in conjunction with the core staff or, at a minimum, the General Manager.

² Including fringe benefits; e.g., housing allowance and pension contribution (see page 18 for budget).

It is also recommended that technical assistance be utilized in the recruitment process, which otherwise is likely to be time consuming and frustrating.

It is recommended that once the funding of the Commission is resolved (see the following section on the Budget) and the Act has become effective, the recruitment process should begin for the General Manager, the Administrative Assistant, and the Accountant, with the objective of having these positions filled by January 1994. The licensing and regulatory technical assistance should begin in January 1994 also. Under the Act, potential licensees/registrants who have been in the business for the previous 12 months have 60 days after the effectiveness of the Act to file applications.

The objective of the technical assistance in the licensing and regulatory drafting areas will be to complete by March 31, 1994:

1. The licensing/registration processing (including the design of forms) of all applications received from existing industry participants per Section 78 of the Act.
2. The licensing (including the design of forms) of the JSE after satisfaction of all requirements of Section 18, Second Schedule, of the Act. This will include a review and approval of the JSE's post trade clearance and settlement system and surveillance procedures.

(The Act allows for 1 and 2 to run beyond six months after effectiveness of the Act. Item 2, in terms of realization of the post trade system and surveillance procedures, will run well beyond six months after effectiveness if the Act. However, the initial phase of the technical assistance being provided to the JSE will be completed by December 1993, and the Commissioner's review of the JSE's phase can commence thereafter.)

3. Draft any required regulations after first determining the minimum initial regulations necessary for effective regulation taking into account the integration of the JSE's rules with the Securities Act and the coverage provided by the Companies Act. (The regulatory drafting process thereafter will become an ongoing function of the Commission that will reflect modification of existing legislation, e.g., the Companies Act, and the creation of regulations as a function of a developing market.)

PRELIMINARY BUDGET - FIRST 12 MONTHS

<u>Summary</u>	U.S. \$ ³	
Recurring Budget	234,600	
Equipment Cost	55,000	
Technical Assistance	<u>120,600</u>	
Total Costs	<u>410,200</u>	
ILLUSTRATIVE COSTS		<u>Remarks</u>
<u>Core Staff</u>		
General Manager	60,000	Includes fringe benefits such as housing allowance and pension contribution.
Legal Officer	45,000	
Accountant	45,000	
Administrative Assistant	25,000	
Receptionist	<u>10,000</u>	
Subtotal	<u>185,000</u>	
<u>Equipment and Premises</u>		
(Word Processor, Copying Machine, Office Supplies and Forms, Telephone, and Fax)	15,000	Computer terminal for market surveillance purposes to be added when JSE electronic feed is available.
Automobile (2,000 cc)	40,000	
Rent, 2,000 square feet	<u>35,000</u>	Fully taxed basis.
Subtotal	<u>90,000</u>	Allows for expansion during medium term of accounting/inspection department, licensing department, enforcement department, and establishment of a library. New Kingston location at 17.50 per square foot, including maintenance.
<u>Commissioner's Allowances</u>		
Commission Honoraria	12,000	\$167 per month per Commission Member.
Chairman's Expenses	<u>2,600</u>	\$50 per week.
Subtotal	<u>14,600</u>	
<u>Technical Assistance</u>		
Recruitment	45,000	Assumes 30% of first 12 months compensation of General Manager, Accountant and Legal Officer.
Regulation	37,800	Assumes 600 per day.
Licensing	<u>37,800</u>	Assumes 600 per day.
Subtotal	<u>120,600</u>	
TOTAL	<u>410,000</u>	
ILLUSTRATIVE REVENUES		
Cess on Trading	56,400	0.30% of 1992 volume.
License and Registration Fees	63,920	1.00% of 1992 brokerage commissions and exchange trading revenues.
Issues Fees	<u>144,000</u>	0.30% of 1992 volume.
Subtotal	<u>264,320</u>	
Government Budget Contribution		Since the SC revenues will not begin to materialize for at least six months, the funding gap should be considered as the full amount of the first year total.
Other Donor		
TOTAL	<u>410,200</u>	

³ Jamaican \$25.00 = U.S. \$1.00

B. Medium-Term Action Plan for the Establishment and Operation of a Securities Commission

A Master Plan for the development of the capital market of Jamaica needs to be created and, within that plan, the role of the SC. In general, such a plan will have the goal of providing the means for efficiently buying and selling securities and for developing the market through balanced increases in the demand for and supply of securities. The overall approach would be as follows:

- A financial sector survey from published materials.
- On-site analytic study of the financial structure through interviews in the public and private sectors, local firms, institutions, and government agencies.
- Preparation of a report containing the measures considered necessary for the creation of an effective capital market. This report should take into account the Macroeconomic Background — the level and distribution of income, rate of savings, Government financing policies and the resource base. It also should take into account the Institutional Base and Supporting Structures. The Institutional Base is composed of the Central Bank, commercial banks, development banks, insurance companies, and pension funds, among others. The Supporting Structures concerns the quality of the accounting, legal, and educational attributes.

The format of a Supply/Demand Analysis is convenient in this respect. For example, the supply of securities can stem from:

- Privatization of Government Controlled Entities
- Multinational Companies
- Newly Formed Companies
- Existing Public Companies
- Private Companies
- Inducements and Rationale for Each Type to Offer Securities

Demand for securities derives from:

- Development Banks
 - Savings Institutions
 - Commercial Banks
 - Pension Funds
 - Finance Companies
 - Unit Trusts
 - Business Companies
 - Individuals
 - Inducements and Rationale for Each Type to Invest in Securities
- Establishing a training program to carry out the capital market development measures. Here the focus should be on the improvements in professional standards of the staff of the SC and, initially, the certification of brokers (see below), the introduction of the Chartered Financial Analyst Program and the development of an Advance Level course in Securities Analysis and Investment. Although the quality of the financial reporting is relatively high, journalists' training is an element that should be addressed.

The underlying objective for creating the Regulator (the SC) is to enhance Jamaica's Capital Formation through increased investor confidence in the integrity of the secondary market. In turn, the perceived integrity of the market will enhance liquidity. Liquidity is particularly important in enhancing the ability of the primary market to raise capital for new investment (Capital Formation) since investors are reluctant to purchase securities which they will be unable to sell. In some developing countries, the Regulator, in addition to acting as the Regulator, also acts as a Capital Market Development Agency.

As markets have evolved, the optimal method of regulating a securities market is to establish a Securities Industry Governmental Regulator and one or more SROs. The Regulator exercise oversight regulation of the SRO (the Stock Exchange), which is directly involved with the market and the exchange members. The Regulator's role is to ensure that the SRO is properly performing its direct regulatory functions. However, the Regulator has the right to directly regulate the market if and when it is necessary.

With regard to primary market activity, the Regulator should focus on ensuring full disclosure and not become involved in the merits of an offering of securities. It would be an impossible task for the SC to evaluate how much risk is appropriate for investors since each investor will have a different tolerance for risk.

With the above as an introduction in advance of the Plan, there are a number of specific actions in which the SC will be or could be involved.

1. JSE's Clearance and Settlement in accordance with G30 and FIBV Standards

The specifics of these recommendations are set forth in Appendix 2. As part of the licensing process, the SC must satisfy itself as to the JSE's clearance and settlement arrangements, which should be in accordance with the G30 and FIBV standards. The timing of this post trade automation process is likely to span both the short and medium term. The SC is likely to require technical assistance in this area.

2. Automated Surveillance Mechanism to be made part of CSD

Again, as part of the JSE licensing process, the SC must satisfy itself as to the JSE's monitoring and enforcement procedures. The optimal surveillance system would derive from information contained within the CSD. Buyers and sellers would be identified by a unique numbering system and programming developed to identify violations of the Securities Act with respect to front-running (trading in advance of executing a client's order), ramping (market manipulation to artificially raise or lower the price of a security in advance of a size transaction), and insider trading (an insider taking advantage of price-sensitive information that has not been disseminated). A limited access electronic feed should be routed to both (and only) the JSE's Surveillance Department Head and the SC's Enforcement Department Head. Provision for such a system should be made part of the JSE's Post Trade Automation specifications. The SC is likely to require technical assistance in this area.

3. Changes to the Companies Act

The establishment of a CSD will require certain changes to the Companies Act as outlined in the JSE Action Plan. The SC, as a statutory corporate body, should be in position to assist the JSE in having the changes adopted into law.

In addition, as noted under the Short-Term Action Plan for the Establishment and Operation of a Securities Commission, the provisions of the Companies Act relating to the issuance of securities may need to be integrated with the Securities Act. The SC is likely to require technical assistance in this area.

4. Accounting Standards

The SC may find it desirable to become involved in assuring the quality of the accounting standards of issuers and traded companies. This may involve the introduction of Internationally Accepted Accounting Standards rather than reliance on the Standards of Standard Accounting Practice issued by the Institute of Chartered Accountants of Jamaica. The SC may require technical assistance in this area.

5. Additions in the Medium Term

During the Medium-Term Action Plan, the SC's core staff will need to be expanded to include the following personnel:

- Licensing Officer
- Accounts/Inspection Officer
- Enforcement Officer

6. Public Awareness

The Stock Exchange has commenced a publicity campaign to better inform the investing public about the stock market. This program should be encouraged, supported, and complemented by the SC.

Such an effort might include advertising, radio, T.V., seminars and the design of a senior-level high school course of instruction and textbook on share investment. It also might include journalists' training. The SC may need short-term technical assistance periodically for the duration of this program, which could run for a year or more.

7. Corporate Debt Market

The feasibility of enhancing the further development of the corporate bond market should be examined. The bond market's development logically would follow the Central Bank's efforts with respect to a secondary market for treasury bills.

8. Improvement of the Professional Standards of Industry Participants

The SC should lead the organization of an effort to raise professional standards through the introduction of broker/dealer, investment adviser certification requirements — similar to the U.S. Securities and Exchange Commission's (SEC) Series 7 registered representative examination. A course study guide would need to be developed that would contain the most relevant aspects of the Securities Act, JSE's Rules, the Financial Instruments in Jamaica, Tax Consequences, Code of Ethics, Financial Analysis, Valuation and Portfolio Management, and Disciplinary Procedure. Every industry participant should be required to pass an examination testing his/her comprehension of the course material in order to retain or obtain his/her license. The SC may need short-term technical assistance in this area periodically over a year until the program is sustainable.

A further step would involve the introduction by the SC of the CFA program into Jamaica. The CFA program is an internationally recognized program of Securities Analysis and Portfolio Management that is administered on a correspondence-course basis from the Association for Investment Management Research in Charlottesville, Virginia. The correspondence courses could be supplemented with periodic

short-term technical assistance instruction. The course is rigorous, demanding and substantially the equivalent of a Masters Degree in Finance. It is administered in three Levels, each running from January through September.

The staff of the SC should also benefit from training in such areas as Functions of Broker/Dealers, Constituents of Securities Markets, the Regulatory Authorities, Secondary Markets, Role of Accountants, Securities Analysts and Attorneys, Unit Trusts, Insider Trading, Takeover and Mergers, Enforcement and Discipline, Central Securities Depository, and Education of Investors. The SC is likely to require technical assistance in this area.

9. Study Tours

Selected members of the SC could be sponsored by USAID/Jamaica to attend the IISMD Program presented by the SEC in Washington, D.C., every March/April. (Wain Iton, General Manager of the JSE, attended the 1992 program). Usually, around 40 or so developing countries are represented each year, and the IISMD Program is an excellent way of assimilating information and meeting counterparts to share experiences and develop solutions to problems.

Additionally, consideration should be given to regional study tours, particularly the Securities Exchange of Barbados and the Trinidad and Tobago Stock Exchange, with which there exists cross border activity with the JSE.

Depending on the development of the SC and JSE, consideration might also be given to the SC and JSE's hosting, with USAID/Jamaica sponsorship, a Regional Emerging Markets Conference. This would be an ambitious undertaking; if successfully executed though, it could put Jamaica in a leadership position for regional cooperation in securities market development.

10. IOSCO and COSRA

As the name implies, IOSCO is the primary international organization of securities regulators. The SC should join IOSCO as an associate member, at a minimum. (Currently, the JSE is a member of IOSCO. This will change as the JSE comes under the SC.) In addition, the SC should consider joining COSRA. COSRA was founded in 1992 by securities regulators from North and South America and the Caribbean to promote the development and harmonization of securities markets throughout the Americas. There may also exist a specific organization for Caribbean regulators/markets that could be explored.

11. Planned Outputs — End of Project (1996-97)

It should be understood that Macroeconomic Factors beyond the control of the SC (e.g., interest rates) affect the performance of the market and its capital raising ability.

- Continue review and monitor the development, installation and start-up of the JSE post trade automation and automated surveillance mechanism.
- Complete the integration of the securities provisions of the Companies Act into amendments to the Securities Act. Continue development of regulations.
- Flesh out the organizational structure of the commission to include a Licensing Officer, an Accounts/Inspection Officer and an Enforcement Officer.

- Evaluate whether the SC is to become involved with assuring the quality of accounting standards.
- Determine feasibility of further development of a corporate bond market and initiate a corporate debt market action plan, if feasible.
- Develop public awareness program to complement JSE publicity.
- Develop Advance Level course on investment in financial instruments — principally company shares.
- Develop training programs for the improvement of professional standards of industry participants. Implement a broker certification program.
- Initiate CFA Program.
- Develop a program of study tours for selected Commission Members and staff — IISMD Washington, D.C., and regional study tours.
- SC to join IOSCO and consider joining the COSRA or other relevant regional body.
- Consider hosting a Regional Emerging Markets Conference.

12. Medium-Term Indicators — End of Project (1996-97)

- A functioning SC exercising oversight regulation over an SRO, the JSE.
- An efficient post trade clearance and settlement system installed in the JSE in accordance with international standards.
- Elimination of the backlog of uncompleted trades.
- An automated market surveillance system installed in the JSE with an electronic feed and direct accessing capability to the SC.
- All Broker Dealers, Investment Advisers, and their representatives certified and training for certification firmly emplaced.
- A specified number of Level I Graduates of the CFA Program and a means for institutionalizing CFA program management and delivery in place.
- Coordinating firmly institutionalized mechanism between Privatization Program and the SC.
- Improvement in the liquidity ratio (the value of shares traded as a percentage of average total market capitalization during a period).
- An increase in the amount of capital raised.
- An increase in the number of listed companies.
- Attendance by Chairman, General Manager, and Legal Officer of the SC at the annual IISMD Program in the course of this period.
- Securities Commission membership in IOSCO.

TASK 2. PERFORM AN ANALYSIS OF PLANNED ASSISTANCE TO THE JAMAICA STOCK EXCHANGE ON THE MISSION'S SUPPORT TO THE REGULATORY AGENCIES WITHIN THE FINANCIAL SECTOR AND PROVIDE RECOMMENDATIONS TO COORDINATE EFFORTS IN THIS AREA

Utilizing its own resources, the JSE has contracted Citibank to provide technical assistance to upgrade its post trade operations. Later, the JSE's trading operations may be upgraded.

The Securities Act requires the SC to be satisfied with the clearance and settlement procedure of the JSE's as well as its monitoring capability. So long as the clearance and settlement procedures are in accordance with international standards, the SC should be satisfied. Citibank's terms of reference are to establish automated clearing and depository facilities and to design a securities trading, clearance, and settlement system that conforms to international standards and meets stringent tests of efficiency, low transaction cost, high transparency of transactions, and scripless trading. Appendix 1 contains an outline of the phases that Citibank sees for the modernization of the JSE.

The best way of evaluating the design of the CSD is with reference to the standards developed by the two most widely recognized international bodies, G30, and FIBV. Of the two bodies, the most widely accepted standards are those of G30, an independent, non-profit organization of business people, bankers, and representatives of financial institutions from around the world. G30 has published 9 recommendations for the world's securities markets that are aimed at "maximizing the efficiency and reducing the cost of clearance and settlement" and thereby reducing risk.

The international standards of G30 and FIBV provide an objective set of criteria for the SC to decide whether the JSE has made satisfactory provisions for "clearing house facilities or arrangements for ensuring performance and settlement and recording of transactions effected on the exchange." Appendix 2 contains the G30 and FIBV recommendations.

The JSE should also have designed a monitoring/market surveillance system as described in the JSE Draft Action Plan - Summary Recommendations (page 10) at the same time that the CSD is designed. As described earlier, an automated surveillance mechanism refers to computer-based surveillance systems that automatically perform Stock Watch trading functions, which identify unusual price/volume movements. If coupled with information from the CSD, an unusually efficient surveillance mechanism will be available.

The CSD cannot function unless certain changes to the Companies Act are made. In particular, provisions must be made to enable the CSD to become the owner of record of securities, which are beneficially owned by investors. In addition, securities must become fungible so that, for example, a particular share of a company is interchangeable with any other share of that company. (See Appendix 3).

The cost of the equipment necessary for the CSD and other elements of the JSE post trade automation system may need to be met with funds other than the IDB - Multilateral Investment Fund since the IDB will not pay for equipment. However, the IDB is ready to consider providing funding for technical assistance related to the installation and functioning of the JSE's system. The IDB indicated that it could consider funding the software development costs of the new system. These can be substantial and are conceptually related to technical assistance. It would also be helpful if the IDB could support the cost of a medium-term adviser to assist in the installation and start-up operations of the system.

Based on conversations with the General Manager, the JSE envisions installing a fully integrated post trade system that would include clearance and settlement, custody, broker-investor-market linkage, accounting functions, surveillance and a market information system. This post trade system is badly needed. Backlogged trades are a significant problem of currently undetermined dimensions since brokers no longer are able to report the level of this backlog to the Exchange. The actual trading system, via call-over, should be changed to a form of continuous trading after the post trade system has been implemented.

As noted earlier, the SC will need to assess the compatibility of the JSE Rules with the provisions of the Securities Act. Missing or incompatible Rules should be adopted or amended by the JSE so that the JSE can become licensed and its Rules enforced. (One of the JSE Rules that may be misinterpreted by the SC requires all employees of a member firm to execute all their own trades through that member firm. The purpose of this Rule is to enable the member firm to discover and prevent such market abuses as front-running, ramping, and insider trading by their own employees. An unwritten JSE Rule that should be made formal requires the member firms to file a monthly statement showing that they are in compliance with a 5 percent [19:1] aggregate indebtedness to net [haircutted, i.e., assets reduced in value in proportion to their lack of liquidity or subjective value] capital. This follows a Canadian model and may be a sufficient cushion.)

The JSE, upon the effectiveness of the Securities Act, will need to switch its membership from IOSCO to the FIBV. (Wain Iton, General Manager, did not specify whether the JSE was already a member of the FIBV. The JSE receives reports from the FIBV but has never attended a meeting.)

TASK 3. DEVELOP AN ACTION PLAN FOR THE REFORM AND MODERNIZATION OF THE BANK OF JAMAICA, SUPERINTENDENCY OF INSURANCE COMPANIES, AND SUPERINTENDENCY OF UNIT TRUSTS.

Bank of Jamaica

According to the Governor of the BOJ, the BOJ is already addressing its technical assistance needs in the open market operation area (purchases and sales of treasury bills). He has been in contact with a Bank of Canada consultant funded by the Canadian International Development Agency (CIDA). In addition, the Governor is in touch with two members of the staff of the Federal Reserve Bank of New York and has access to their training courses. The Governor is in the process of setting-up a trading room for both Government securities and foreign-exchange dealing. The IDB also is funding consulting work in the secondary T-Bill market with two consultants from a local firm, Data Resources Systems International, Ltd.

An area of concern for the Governor is Banking Supervision, which may become critical since problem loans are likely to increase as the growth in the money supply is curtailed. The Governor had planned to secure the service of an expatriate International Monetary Fund (IMF) candidate from Zambia who now is unavailable. The Governor is also seeking other help from the IMF. However, the Governor feels that an in-house permanent training program is the ultimate solution and a top-priority. The whole area of Building Societies (S&Ls) regulation needs to be addressed also.

In a parting comment, the Governor expressed concern over the JSE's backlog of uncompleted trades and felt that the sooner a simple post trade mechanism was put in place, the better. His/her stress on a simple system was based on unhappy experiences in Canada and elsewhere that had started with sophisticated systems.

The technical assistance requirements listed below should be met by expatriate experts familiar with the U.K. banking system and Bank of England procedures:

- Banking Supervision Expert — assist in establishing a monitoring, internal management assessment and early warning system. Design and initially implement an in-house training program for Supervision Personnel.
- Building Society Expert — design a regulatory structure and assist in its implementation.

Outputs anticipated are as follows:

- A monitoring, internal management assessment and early warning system accepted by the BOJ.
- A regulatory structure accepted by the BOJ.

Superintendencies of Life Insurance Companies and Unit Trusts

The Superintendent of Life Insurance Companies and Unit Trusts needs technical assistance and equipment support particularly for regulating the pension fund management activities of Life Insurance Companies and the portfolio management activities of Unit Trusts. Currently, there are no regulations with respect to pension fund management activities of life insurance companies, other than the responsibility of the Trustees (which may be principally custodial) and the ability of a company to switch

its employees' accounts from a poorly performing pension fund manager. There is not even a requirement for the Life Insurance Companies to report on their pension fund management activities.

Similarly, the Unit Trusts, while formed under the Unit Trust Act, have no portfolio management guidelines as part of their regulations. Skeletal portfolio guidelines may be incorporated into the Trust Deed establishing a given trust. The Trustees of a Unit Trust have a responsibility to see that the investment manager of the Unit Trust performs his/her duty in accordance with the Trust Deed.

The Unit Trusts must file periodic reports with the Superintendent of Unit Trusts, who is so overwhelmed with other work that he simply files the reports without any analysis. In addition, at least one of the Unit Trusts has been experiencing delays in processing contracts, encashment of units (redemptions) and the provision of information necessary for the payment of dividends.

In terms of the amount of money and number of investors involved, the figures are as follows:

	J\$	No. Participants/Unit Holders
Life Insurance Company Managed Pension Funds	6.5 Billion Est.	250,000 Est.
Unit Trusts	<u>2.0 Billion Est.</u>	<u>50,000 Est.</u>
Total	<u>8.5 Billion Est.</u>	<u>300,000 Est.</u>

The number of Unit Trusts is growing, and the Superintendent estimates that 15 new trusts will have been formed in the next 12 months, bringing the total to 20. There is no Unit Trust association.

The Superintendent's office experiences high turnover and has inadequate equipment resources to cope with the data flow from the reporting requirements of the Life Insurance Companies life business. In addition, the production of the Superintendent's Annual Report, a statutory requirement, is backlogged. The 1990 Report has been at the printer's office for six months. The Superintendent has been told that no help from the Government will be possible for a year.

Potential for abusive pension fund management practices are a threat to the stability of the financial system. In particular, self-dealing between a Life Insurance Company and the pension funds under its management has occurred and is not regulated or reportable.

The Superintendent needs technical assistance in the areas of:

- Law
 - Caribbean Law Institute Draft Model Insurance Bill
 - Regulatory provisions for Pensions Funds and Unit Trusts
- Supervision and Monitoring
- Actuarial Procedures

In addition, the Superintendent needs equipment to handle data flows so that reports can be submitted via diskette and software developed to log-in and access a database. This will require a mainframe computer (beyond entry level) and personal computers.

For the Superintendent of Life Insurance Company, the technical assistance requirements are as follows:

- Develop regulations for Life Insurance Company management of pension funds.

- Design supervision and monitoring procedures to enforce compliance with the regulations developed.
- Provide technical assistance on actuarial procedures to be utilized by the Life Insurance Companies.
- Provide data processing equipment, a mainframe computer and terminals, to manage Life Insurance Companies reporting data flows to the Superintendent.

Technical assistance should be provided with respect to developing regulations for pension fund management by an expatriate familiar with U.K. pension fund management regulation.

Technical assistance on actuarial procedures also should be requested to outline the data processing equipment needs to be assessed by an expatriate expert.

The expected outputs are as follows:

- A regulatory structure for the management of pension funds by Life Insurance Companies.
- Actuarial procedures conducted in accordance with internationally accepted practices.
- Appropriate data-processing equipment in place.

For the Superintendency of Unit Trusts, the technical assistance requirements are as follows:

- Develop appropriate additional regulations; assess the feasibility of organizing a Unit Trust Association with some features of a SRO.
- Assess the feasibility of shifting responsibility for the regulation of Unit Trusts to the SC after it has been established and is functioning.

An expatriate expert knowledgeable of the U.K. Unit Trust system would be appropriate.

The intended outputs would be as follows:

- Appropriate additional regulations drafted and accepted by the Superintendent.
- The feasibility determined of establishing a Unit Trust Association with selected SRO features.
- The feasibility determined of shifting regulatory responsibility of Unit Trusts to the SC.

APPENDIX 1
CITIBANK TERMS OF REFERENCE FOR THE JAMAICA STOCK EXCHANGE

The following terms of reference are based on a letter from Faith Hamilton, Vice President of Citibank, to Jacques Cook, Resident Representative, IDB, dated June 21, 1992, to establish automated clearing and depository facilities and to design a securities trading, clearance, and settlement system that conforms to international standards and meets stringent tests of efficiency, low transaction cost, high transparency of transactions, and scripless trading.

Phases:

1. Developing a strategic plan.
2. Assessment of current market environment and needs.
3. Review of potential business models:
 - Trading
 - Clearance, settlement, and depository
4. Review of business economics
 - Capital investment
 - Service pricing and fees
 - Annual operating expenses
5. Development of a migration strategy and implementation plan.
6. Development of decision-making infrastructure for technology and systems selection:
 - Functional and systems specifications
 - Requests for Proposals
 - Evaluation framework for short listing and selecting potential vendors and supplies
 - Securing services contracts with chosen suppliers
7. Development of training framework.

APPENDIX 2
THE G30 AND FIBV RECOMMENDATIONS (ISSUE DATE, MARCH 1989)

1. By 1990, all comparisons of trades between direct market participants (i.e., broker/dealers and other exchange members) should be accomplished by T + 1 (T here means trade date).
2. Indirect market participants (such as institutional investors or any counter-parties that are not broker/dealers) should be members of a trade comparison system that achieves positive affirmation of trade details by 1992.
3. Each country should have an effective and fully developed central securities depository organized and managed to encourage the broadest possible industry participation (directly or indirectly) in place by 1992.
4. Each country should study its market volumes and participation to determine whether a trade netting system would be beneficial in terms of reducing risks and promoting efficiency. If a netting system would be appropriate, it should be implemented by 1992.
5. Delivery (of securities) Versus Payment (DVP) should be employed as a method for settling all transactions. A DVP system should be in place by 1992.
6. Payments associated with the settlement of securities transactions and the servicing of securities portfolio should be made consistent across all instruments and markets by adopting the same-day funds convention.
7. A "Rolling Settlement" system should be adopted by all markets. Final settlement should occur on T + 3 by 1992. As an interim target, final settlement should occur on T + 5 by 1990 at the latest, except where it hinders the achievement of T + 3 by 1992.
8. Securities lending and borrowing should be encouraged as a method of expediting the settlement of securities transactions. Existing regulatory and taxation barriers that inhibit the practice of lending securities should be removed by 1990.
9. Each country should adopt the standard of securities messages developed by the International Standards Organization (ISO Standard 7775). In particular, countries should adopt the ISIN numbering system for securities issues as defined in the ISO Standard 6166, at least for cross-border transactions. These standards should be universally adopted by 1992.

It should be noted that no markets (including the U.S. markets) yet fully comply with the G30 recommendations.

The FIBV Recommendations⁴

1. Adoption of international settlement conventions.

These are essentially summaries of the G30 recommendations described above.

⁴ Excerpted from "Proposal to provide consulting assistance for establishing a modern securities market infrastructure in Jamaica," Price Waterhouse, April 16, 1993.

2. Cross Border Settlement Links.

Provided there is a business need and sufficient transaction volumes, all National and International Central Securities Depositories (CSD) should establish links with each other, based on specific agreements, for as wide a spectrum of services and international trade securities as possible. This should be examined with regard to cross-border trading with the Securities Exchange of Barbados and the Trinidad and Tobago Stock Exchange

3. Securities Immobilized in the Country of the Issuer and transferred by book-entry.

Physical documents of title to securities listed and/or traded on a foreign stock exchange as well as their home stock exchange should remain in their home country and should be immobilized in their original form as a CSD, which affects securities transfers by means of book-entry.

4. Listings abroad in Original Form.

Stock exchanges that list or trade foreign securities should stipulate that good delivery of such securities can be in their original form and accomplished by book-entry transfer in the home country's designated CSD or by an international central depository. The underlying securities should be held by the designated CSD in the home country in accordance with Recommendation 3 above.

APPENDIX 3
IMPLICATIONS WITH RESPECT TO THE LEGAL
FRAMEWORK FOR A CENTRAL DEPOSITORY SYSTEM⁵

A depository acts in a trust capacity by holding shares on behalf of its institutional participants (including banks and brokers) and other investors. Accordingly there must be a body of trust law that governs the rights and obligations of a depository and participants with respect to securities on deposit and imposes fiduciary obligations on the depository.

The following types of provisions need to be incorporated in a country's commercial law at the time a depository is established:

- A transfer (settlement) of a security must be legally valid when made by book entry instead of through physical delivery. In addition, the relationship between legal title and beneficial ownership of the securities must be established, as a transfer within the system will not constitute a registration transfer on the stock transfer records of the issuer and thus does not transfer legal title, but only changes the beneficial owner of the securities.
- Transferees through the book-entry system must obtain good title to the securities purchased.
- It must be possible to make and release pledges, which will evidence the rights of lenders in securities used as collateral, through the book-entry system.
- Securities must be "fungible," i.e., transferable without regard to specific shares or certificate numbers.
- Entries on the books of the depository that are inappropriate must not affect the validity or effect of the entries of the obligations of the depository to any person adversely affected.

⁵ Source: Report of the Company law Review Committee on the Reform of Company Law in Jamaica 1993, Appendix N.