



**"FUND MANAGEMENT IN THE CARIBBEAN:
RAPID GROWTH AND REGULATORY
CHALLENGES"**

*DELIVERED
BY*

**DR. MARION WILLIAMS
GOVERNOR
CENTRAL BANK OF BARBADOS**

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Mr. Chairman, Dr. Ramsaran; Minister Sahadeo; Governor Ewart Williams; Deputy Governors; Mr. Kelvin Sargeant.

I wish to congratulate the Caribbean Centre for Monetary Studies Centre (CCMS) on the choice of the theme for this year's seminar. The CCMS is in the process of restructuring itself. As part of the restructuring it is intended that the CCMS spreads the scope of its coverage beyond central banks and commercial banks to include investment banks, mutual funds and securities companies, as well as insurance companies, some of which currently fall under the jurisdiction of some central banks. The timing of this seminar is also in recognition of the fact that an increasing proportion of funds are now invested under management.

Regional Issues

Also, in the glare of globalisation and regionalisation the region is facing both old and new challenges, among them is the need to

increase the ratio of our savings and investment in order to fund development.

Some of the more pressing features and challenges include:

- Slow growth in some jurisdictions;
- Rising fiscal debt burdens;
- Sluggish and disproportionate job creation;
- Loss of economic and human capital/potential;
- Global competition from new economies – attacks on both the trade and service sectors;
- An increasingly ageing population - a threat to the subsistence of national social security systems.

These challenges, however, also offer opportunities. There can be positive outcomes if the correct procedures and frameworks are put in place and these challenges can also serve to harness fully the

growth enhancing potential of the financial sector and enhance its role in the region's development.

With increasing assets under management, the investment industry faces several challenges that must be addressed to ensure that the interests of both the investors and the asset managers are best served. In some jurisdictions growth of funds outside the banking system has been more rapid than the growth of deposits of commercial banks. This means that the funds management sector deserves increasing attention.

In recent years, there has been an increase in investor interest and consequently, a rapid emergence of investment products being offered to both retail and institutional investors. There has been a spurt in the growth of investment vehicles such as mutual funds, pension funds, unit trusts, insurance products and the introduction of principal protected and equity-linked products.

This growth has been global and the Caribbean is beginning to share in this rapid expansion. It is being accompanied by greater integration of financial services world-wide.

The benefits of an enhanced, integrated, financial services sector are:

- increased efficiencies;
- better allocation of resources;
- reduced costs and increase returns for all market players; and
- a boost to capital formation; investment; economic growth.

These developments must also be accompanied by appropriate regulation. We must, however, ensure that we do not over-regulate and that our regulation is harmonised and does not lead to regulatory arbitrage either between sectors or among countries within the region.

Harmonisation of Regulation

Given the current state of the financial services industry in general, and the fund management industry in particular, the regulatory framework should be used as an enabler that assists in opening new markets, that increases choice and generates new opportunities. Creating the right regulatory framework is essential for the industry to succeed. The days of policy and regulatory barriers that have resulted in fragmented financial markets in the region are numbered. Good regulation is therefore vital for the region, as markets need sound and stable rules in order to develop.

Initiatives such as the development of common codes of conduct, registration procedures, fee disclosure (of fund-processing) or governance and compliance with standards, such as the GIPS standard can help regional markets to function with a greater level of transparency. The regional single market can also develop more effectively if actors understand the need for cooperation and regulatory convergence, and work together to find common rules and which are enforced by those who have agreed to them. Investors and market actors will feel more confident if rules are clear and enforceable. We must, however, be sensitive to the

environment in which we operate in developing common rules, as we do not want to stymie a market which is just at take-off stage. Ensuring a level playing field is the key to the industry's success. However, we must be always mindful that new challenges are not always the purview of the regulatory agencies. A greater level of the burden should be placed on market forces and market actors. They too must be part of the process.

Adequate Staffing of Regulation Offices

Regulators must keep abreast of all developments within their industry, not only as it relates to new and emerging instruments but focus must also be placed on industry trends and practices both regionally and globally. There must be information sharing so that all actors are knowledgeable of what is happening in the related jurisdictions.

Timelines of Inspections

As assets under management increase, it is critical that inspections, both on site and offsite are performed on a timely basis to ensure that any breaches in regulations are addressed within a reasonable time-frame.

Inspections should focus on entire operations of the fund managers with emphasis also placed on the investment managers, investment advisers and custodial firms with whom business is conducted to ensure that exposure to reputational risk is also minimised.

New Markets and Products

I wish to spend a moment on the growth of the funds market. Financial assets are probably the fastest growing assets in the world. Across the globe, there has been an expansion in the growth of cross-border funds within individual countries both in Latin America and the US. However, efficient coordination needs to be enhanced in order to be able to exploit the untapped potential of the relevant markets including back office roles and clearing and settlement procedures. What is needed also, is a more liquid pan-Caribbean market with lower transactions costs. Cross-border trading remains expensive, sometimes prohibitively so. In these circumstances, potential investors are not able to take advantage of price differences because transactions costs wipe out potential gains. Also, it is essential that stakeholders do not behave in a way that undermines the development of deeper, more liquid capital markets or undermines competition or the safety of systems.

At the regional level, new distribution models offer investors greater access to a wider range of products. However, this can lead to additional players in the financial services chain, blurring the responsibilities towards consumers. We must also closely monitor the risks and opportunities of new investment strategies and products including alternative instruments and the hedge fund sector that may be part of the development strategies of the market participants and the self-regulatory organisations (SROs). Market dissemination of information and valuation of securities need to be regular, timely, accurate and independent and market education - a key aspect of market development - needs to be enhanced. A more sophisticated and educated investor base can serve to allay market disruption and the process can be cost effective. There may be a role here for greater collaboration within the University in developing this educational role.

There is also a perception that the current regulatory framework needs to be revamped to be able to keep pace with financial innovation so that it does not impose restrictions on creative and competitive products. We need to ask if the current framework encourages the opportunities for product providers and for investors.

There will be instances where there may be a need for the involvement of a host of regulators in the jurisdictions in order to clarify the boundaries and respective responsibilities of different actors within the services chain. There is also a need to develop viable common, cross-jurisdiction operational standards and procedures in order to realise market efficiencies.

Cash Flow Challenges

With the growth in the industry, there are the associated large inflows of cash on regular basis. Due to the relatively low level of investment management activity (IPO, new issuance) in the Caribbean, the supply of eligible and available regional investments may not be sufficient to satisfy the demand of asset managers. This can result in some funds recording excessively high cash balances, which negatively impact on the performance of the portfolio. With a lack of investment alternatives for savings and investment catering to a range of investors, there may be an increase in spending by market participants and this could be inflationary. It is important, therefore, that we create vehicles to harness these funds.

Valuation Methods

In the less-developed markets in the Caribbean, or where there are high levels of investment in unlisted securities, the valuation of the holdings in the portfolio can be problematic. Mechanisms must be implemented so that in such cases, market values used for valuation can be independently verified, and the basis for the valuation known in advance.

Risk Management

As there is no derivatives market in the Caribbean, another challenge faced by fund managers is the lack of risk management tools in the mitigation of foreign exchange, interest rate and market risk exposures. As the securities industry develops, some consideration must be given to the development of tools, which can be made available to assist regional managers in the management of these risk exposures.

Performance Measurement and Reporting

The comparability of portfolio returns across similar investment strategies of managers should be subject to the implementation of standardised performance measurement and reporting standards. Currently, in the absence of such standards, fund managers have

been disseminating investment returns that could be calculated using different methodologies resulting in investment information that is not truly comparable.

To enhance the integrity of the performance reporting and calculation of returns the implementation of the Global Investment Performance Standards becomes important.

In the final analysis the growth of the securities market and the development of the funds sector is likely to continue to attract increasing interest as investors search for diversified assets, as the funds sector is likely to continue to be a high growth sector. We must be careful that nurture its development.