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FEATURE ADDRESS

at the

Launch of the Caribbean Information and Credit Rating Services Limited

by

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The Central Bank of Trinidad and Tobago is delighted to participate in this launch of the Caribbean Information and Credit Rating Services Limited (CariCRIS).

This is a long overdue initiative. CariCRIS is a unique construct with all the desired elements of the CARICOM integration. Its shareholders include the regional private sector, the regional official sector as represented by the Central Banks of Trinidad and Tobago, Barbados, and of the Eastern Caribbean Central Bank and the Caribbean Development Bank. For good measure, there is representation from the multilateral financial community (through the Inter-American Development Bank). In my view, this shows public, private and international cooperation at the highest level and reflects well on the development and maturity of our financial system.

The coming into being of **CariCRIS** owes much to the foresight and tireless efforts of several people and, without trying to name them all, I would like to pay special recognition to the originators, Mr. Ram Ramesh of Caribbean Money Market Brokers, Mr. Ron Harford of Republic Bank Limited and Mr. Terrence Martins, our current Chairman. These gentlemen recognized the importance of having a regional credit rating agency and decided to make it happen, and here we are today.

As you know, the financial sector in the Caribbean has been growing very rapidly with the driving force being Trinidad and Tobago. The phenomenal development of the sector has however been unbalanced. The banking sector has faced tremendous growth, but the regional capital market has not developed at a commensurate rate. Even within the capital market, the equity segment has languished while the collective investment schemes such as the mutual fund industry as well as the regional debt markets have made remarkable strides.

As an indication, in Trinidad and Tobago alone, by mid-2004, there were some sixty mutual funds with more than TT$20 billion under management. As regards our local market for corporate and sovereign debt, over the last five years there have been close to 200 bond issues registered by the Trinidad and Tobago Securities and Exchange Commission, amounting to about $40 billion. The local state enterprise sector has accounted for about 36 percent, central government issues for 18 percent, and regional governments and corporations 40 percent. The local private sector has accounted for less than 10 percent of the bond issues listed. The pattern is much the same in Jamaica, Barbados and the rest of the Caribbean.

The pace of this emergence of our regional capital market has an important effect on our rate of development since these markets provide investors with opportunities for investment and risk diversification; they permit companies and government to raise long term resources at lower costs, and they promote greater efficiency and competitiveness in resource allocation. The pattern is much the same in Jamaica, Barbados and the rest of the Caribbean.

Experts have advanced several factors for the less than optimal performance of the region's capital markets. While not trying to list them, suffice it to say that a major factor frequently cited is the **lack of transparency in the pricing mechanism**. On this account, the coming into being of CariCRIS, our regional credit rating agency, could serve to further enhance the efficiency of resource allocation, improve transparency and provide a boost to the capital market.

Credit rating agencies have been a part of the infrastructure of the financial market of developed countries for several years. One of the fundamental problems that financial markets must overcome is the presence of asymmetric information between savers and investors in real assets – essentially between the provider of funds and the user of these funds. In the case of commercial bank loans, for instance, the banks bridge this information asymmetry; the banks in effect protect our deposits by assessing the creditworthiness of those to whom they lend. In the case of financial markets, the investor is more exposed; he does not have similar protection and he needs to rely on your own judgment or that of information vendors. Credit rating agencies are one of a range of information vendors available to investors.

In developed countries, financial markets are characterized by the public disclosure of information by issuers of marketable securities. Indeed, in most cases, security laws require corporations to disclose information continuously about their business operations. In addition, there is invariably a whole range of information systems to supplement the information provided by the issuer.

In our Caribbean environment, information of this sort is at a premium. The investor is essentially on a "need to know basis". The recent White Paper on Financial Sector Reform in Trinidad and Tobago identified disclosure reporting and dissemination of information as being extremely inadequate for investors to make appropriate and timely investment decisions. It also identified an important role for commercial vendors to assist in the production and dissemination of information. **CariCRIS, the regional credit rating agency will attempt to fill this void.**

Moody's described the role of credit rating agencies as providing "through a simple symbol system, objective and independent opinions of relative credit risks that investors can use as **a supplement to, but not as a substitute for their own internal credit research**". The value of credit ratings is therefore based primarily on improving the quality of information on issuers of various forms of debt to the benefit of both lenders (investors) and borrowers (issuers). As products become more complex, the views of expert third parties are more than useful; they are essential.

Credit ratings are important to all the stakeholders involved in the capital market.

They can play a significant role in investment decisions of investors and in mature markets, the value that investors place on such ratings is evident from the impact they have on the issuers ability to access capital.

Issuers also use credit ratings for a number of reasons such as to improve the marketability or pricing of their financial obligations or to meet regulatory requirements.

In several countries, institutional investors, the largest owners of fixed income securities, are substantial users of information from credit rating agencies even though they typically conduct their own credit analysis for risk management purposes. In some countries, firms may also use credit ratings to comply with internal bye-law restrictions or investment policies that require certain minimum credit ratings for regulatory requirements.

Of course, the credit rating agencies are not entirely new to the Caribbean and the names of the three global rating agencies (Standard and Poor's, Moody's and Fitch) are fairly well known. In these circumstances, one might ask, why CariCRIS?

The simple answer is that **currently the coverage of firms by these global agencies, particularly for non sovereigns**, is very thin. Moreover, most of these ratings are for foreign currency borrowings calibrated on a global frame of reference. On this basis, the ratings of countries and corporations across the Caribbean tend to be pegged at the bottom end of the rating scale, when compared with stronger and larger economies and global corporations. For most Caribbean investors, the relevant frame of reference may be limited to a country or the Caribbean region. For the Caribbean investor, what would be useful is a benchmark of how credits compare with one another, either within the

Caribbean or within a particular country. CariCRIS, our regional credit rating agency, is ideally positioned to serve this end.

But we should avoid the temptation to see any credit rating agency as a foolproof way to avoid default or for picking winners. If we had any doubt of this, the failure of credit rating agencies to prevent or warn of the impending failure of ENRON or WorldCom becomes difficult to explain. If there is any lesson from these incidents, it is that credit ratings are as useful as the quality of the information provided and the integrity of the accounting, auditing and regulatory standards applicable.

From the Central Bank's own perspective, we have a profound interest in the establishment and the success of CariCRIS. First, we see it as another critical step in the development of the country's financial system infrastructure – in the same way as we see the recently introduced auction system for government bonds and the ongoing upgrading of our financial sector legislation. We have a special interest in CariCRIS also because we expect it would strengthen our market infrastructure and reinforce our regulatory framework.

As you may know, the Basel Committee on bank supervision is proposing to use credit ratings to differentiate credit risk for the purpose of capital adequacy guidelines. If and when this comes into force, a change in the rating of a bond could impact on the regulatory threshold and trigger increased capital requirements for the financial institutions concerned. This is already happening in the mature markets. It's just a matter of time before it is adopted by jurisdictions in the Caribbean.

Ladies and gentlemen, CariCRIS promises to bring a number of significant benefits to the region as it impacts on regional capital markets:

- investors for the first time would be able to objectively compare credit risks in making investment decisions;

- CariCRIS could provide the impetus for greater integration of regional capital markets by facilitating more informed cross border investment;

- regional companies normally dependent on traditional sources of financing should be able to raise capital directly from the market at lower costs; and

- spread on bonds and fixed income securities are likely to be compressed as ratings create greater credit differentiation among borrowers since more information is made available to investors.

CariCRIS could also provide the needed support for the secondary market for fixed income securities, as the pricing of securities will make the process more transparent, thus enabling institutions and individuals to trade more actively.

I would expect that CariCRIS will raise the level of awareness and sophistication in our regional capital markets through better informed decision-making as well as through the publication of current information.

In short, CariCRIS can be a major impetus to the accelerated development of our regional capital markets … it is true that the nature of their analysis is largely dependent on the quality of information provided. However, CariCRIS should also note that the creditability it engenders and the success it will achieve will depend, to an important extent, on the quality and rigour of its analysis, and its ability to avoid the potential conflicts of interest that invariably arise when issuers pay for ratings.

At least initially, CariCRIS will be subject to little, if any formal regulation or oversight. It would need to set its own higher standard for excellence, accountability and integrity.

I am sure that CariCRIS will be more than equal to the challenge.