

You there! Are you awake?

BY ROWLAND THOMAS

The bond market seems to be asleep. Since it was launched in January this year the number of trades occurring can be counted on one hand, while the total value of bonds traded was pitiful (possibly near that of the overdraft facilities of many companies.) Why has this happened? After all the buzz when the introductory stages were in progress we seemed to have shut down totally. So where does the problem lie? Even the Trinidad and Tobago Stock Exchange (TTSE), who is a main sponsor of this venture, is asking the same question.

Lack of faith in the operation of the Bond Trading System

When the market was launched, brokerage houses and Government Securities Intermediaries or GSIs (which are the institutions charged with executing trades) sought to encourage their existing clients to become part of the market. The Central Bank of Trinidad and Tobago even placed ads in the newspapers announcing the start of the market along with various articles written by the brokerage houses about the opportunities which would be realised through its use. This was all in an attempt to create a very active market from the onset. However as with most new systems, everything did not go as smoothly as expected. The process of establishing accounts on behalf of clients and having them updated into the bond trading system had its rough spots and lead to clients who were accustomed to the smooth operation of the equity trading system to have their doubts. For example, why can't clients open accounts and trade on the same day? Why initially accounts set up for clients at the Central Bank did not show up in the bond trading system and why was the bond trading system continually shutting down? This resulted in many cancelled orders even before accounts were properly processed. Most people will be relieved to know that now the kinks have been worked out (except the part about setting up accounts and trading on the same day which is unfortunately unavoidable.) These problems no longer exist but why is there still limited activity?

Uncertainty in establishing a price to place an order

In a market where previously prices were determined through negotiations there was imperfect information. No one else knew when a bond was traded and at what price. So how do you begin to put a price on an order to buy or sell in the new system? In Trinidad, there are really two companies who produce a pricing guide for bonds, and although different methods are used in the calculation, most if not all the bonds' prices are close. This actually may be the solution. Compare the pricing guides of both companies and determine a price which is close. This price would represent a fair starting point although it may not be the price that the bond is actually traded at it gives both the buy and sell parties some confidence that the prices they will pay or receive are not arbitrary.

Number and type of Bonds currently available for trading

The bond market currently has only seven bonds which can be traded using the new bond trading system. They were selected because when they were issued, the Central Bank's auction system was used which, as part of the process, avoids the need to issue certificates allowing the register of bondholders to be electronic. This made these bonds

perfect candidates for trading on the new system as the transfer of ownership is done electronically once the trade has been executed. However with only seven bonds to choose from which were issued at a time when coupon rates were low, the prices determined may not be attractive for persons seeking to sell their holdings. Added to that, only Government of Trinidad and Tobago Bonds are included on the system thereby limiting the attractiveness of using the system. Lack of new issuances of bonds has reduced the desire of companies to sell their existing holdings as they have no further securities to buy into. Since there has already been a commitment to increase the number of bond issuances by the Government, we only need to see this realised to attract trades. The Central Bank has also indicated that there will be a schedule of issuances available shortly which would aid in investor's planning their spending more beneficially. The inclusion of corporate bonds however remains a point yet to be properly investigated.

Fees

Prior to the establishment of the bond market, parties involved in a bond trade negotiated a price and paid that price alone for the bond. There was hardly ever an instance where a separate fee was identified for carrying out the trade. So with the new bond system when persons are now faced with a separately identified fee (to the Trinidad and Tobago Stock Exchange and the Brokers/GSIs) for conducting the trade you would expect that there would be some concern. It must be noted that although in the previous system fees were not identified, they were included in the price. The seller of the bond just never had any purpose in showing the fee separately. Now that trading must be done on an exchange and involves the exchange itself and a broker this fee comes to the fore. It might just be the case that the fees on the new system now makes the price of the bond higher but one must remember that there is a law which governs the sale and purchases of financial instruments. This law provides for a stamp duty of 5.00% (Section 24.2 of the Stamp Duty Act) to be paid on all transactions for listed securities not done on the exchange. For unlisted securities traded off of the exchange the stamp duty is 0.5%. If this law was to be enforced, the fees faced when trading on the exchange would be minute as compared to the stamp duty applicable to off the floor bond trades.

The ability of involved parties to “make a market”

To have an active market there must be the existence of companies who are willing to make a market for the bonds available for trading. Unfortunately, brokers do not have the level of capitalization necessary to set up bids and offers on the exchange for which they will be able to back up if the trades are executed. Bonds trade for the most part in minimum denominations of 1,000 so to have a reasonably sized order capable of justifiably influencing the price of a bond, one must have millions of dollars available to settle the transaction. This single-handedly blocks out the brokers' ability to assist in making a market leaving only the GSIs who may not have this function at the top of their list of priorities

For now the bond market continues its lazy existence though the TTSE is trying to find ways of reviving it. However the recent sale of RBTT Bank to RBC means that there will be a lot of cash coming back into the system through previous shareholders of RBTT shares. Where is all this cash going to be invested? The stock market has already begun

to show signs of rejuvenation but other alternatives must be made available by the Government and the answer might just be in the bond market.

Maybe trading will improve in time as the market gets familiar with the market's functionality and the expected increase in the offering of bonds which can be traded on the exchange.

Rowland Thomas

Proprietary Investment Manager

West Indies Stockbrokers Limited (WISE)

rowlandt@wisett.com