TRINIDAD AND TOBAGO'S POLICY FRAMEWORK FOR TRINIDAD AND TOBAGO DEPOSITARY RECEIPTS

TRINIDAD AND TOBAGO SECURITIES AND EXCHANGE

COMMISSION

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Background

As part of Trinidad and Tobago's (T&T's) efforts to deepen the development of its financial markets and establish an International Financial Centre (IFC), the Trinidad and Tobago Securities and Exchange Commission ("the Commission") after thorough consideration has endeavoured to facilitate the introduction of Trinidad and Tobago Depositary Receipts (TTDRs) as a new security. In addition to contributing to the development of T&T as an IFC, the introduction of DRs will have three principal benefits.

First, it will introduce new securities into a marketplace where participants are eager to see new products traded locally. This will contribute to the growth of the local stock market as was indicated by market consultations with local market actors.

Second, it will enable retail and institutional investors in Trinidad and Tobago to achieve greater diversification of their investment portfolios without having to leave the local capital market. This is particularly important in a small country like T&T, where the local market currently offers a limited number of offerings for investment.

Third, the introduction of DRs into the market will have an immediate beneficial impact on the macro-economic environment. T&T is currently experiencing high levels of inflation as a result of excess liquidity in the financial system. To the extent that investors choose to hold DRs, there will be some absorption of this excess liquidity and a resulting reduction in inflationary pressure.

The policy decision to introduce DRs into the T&T market has been taken at this time partly to encourage greater participation by the general public in the development of the capital market.

While the growth of the energy and energy-related sector has fuelled several years of continuous growth of the Trinidad and Tobago economy, none of this growth has been reflected in the stock market, since mainly foreign-owned enterprises that operate in this sector have typically not been listed on the local stock exchange. Moreover, the idea of a local listing has not been attractive to the many family-owned entities in Trinidad and Tobago.

The acquisition of RBTT Holdings Limited ("RBTT") by Royal Bank of Canada ("RBC") has sharpened local concern about domestic participation in significant enterprises operating in the country because this acquisition will lead to the removal of one of the largest and most popular T&T companies from the Trinidad and Tobago Stock Exchange ("TTSE"). This is poignantly represented by the fact that RBTT represented about 15% of the total traded value on the Trinidad and Tobago Stock Exchange in the last two calendar years. The 60/40 stock/cash structure of the transaction will also result in the influx of significant new liquidity into the economy at a time when inflationary pressures are already extremely high.

The Commission, as well as the Ministry of Finance and the Central Bank, have determined that within the context of the RBC/RBTT transaction, a comprehensive regime governing the introduction and operation of a TTDR programme should be put in place as quickly as possible given the current financial environment.

Mechanics of a Depositary Receipt Programme

A Depositary Receipt (DR) is a traded security that represents a company's publicly traded equity or debt on another exchange. In a basic DR programme Foreign Shares are delivered to a foreign Custodian to be held in escrow. Subsequently, a Depositary Agent would be authorized to issue and distribute DRs that represent the Foreign Shares. After these DRs are issued they can then be bought or sold on a local Stock Exchange.

Major components of a TTDR programme

Role of Depositary Agent

The primary role of a Depositary Agent is to service the parties involved in the DR investment process: the Foreign Share Issuer, the Custodian and TTDR holders. Each party requires that the Depositary Agent provide day-to-day administrative functions, such as the maintenance of TTDR holders' records and the handling of enquiries. Services provided are as follows:

- Issue or cancel the TTDRs in the T&T market,
- To exercise the voting rights corresponding to the Foreign Shares in the interests of the TTDR holders,
- To maintain an up to date registrer of TTDR holders
- To facilitate the transfer and disbursement of dividend payments,
- Reconcile the holdings of the Foreign Shares held by the Custodian with the TTDRs in issue,
- To disclosure to the T&T market information provided by the Foreign Share issuer in its market of origin.

Role of Custodian

The role of the Custodian is to hold the underlying Foreign Share against which the TTDRs are issued. The Custodian is required to correspond with the depositary agent to reconcile Foreign Shares in custody with TTDRs issued in the local market. The responsibilities of the custodian are as follows:

- Holding the Foreign Shares underlying the TTDRs for the Depositary Agent on behalf of its TTDR holders,
- Perform dividend collection services on behalf of the Depositary Agent,
- Maintaining a register of the number of Foreign Shares in custody,
- Confirm release and acquisition of Foreign Shares upon cancellation or issue of TTDRs, as instructed by the Depositary Agent,
- Notify the Depositary Agent of notices of shareholder meetings, annual reports and other shareholder communications from the Foreign Share Issuer.

Types of Depositary Receipts

Unsponsored Depositary Receipt

Unsponsored Depositary Receipts are issued by Depositary Agents in response to market demand, but without a formal agreement with the Foreign Share Issuer. For unsponsored programmes a person purchases the underlying Foreign Shares, lodges them with the Custodian allowing the Depositary Agent to issue DRs. The local broker then sells the DRs. In such a programme the Foreign Share Issuer itself is not directly involved.

Sponsored Depositary Receipts

Sponsored Depositary Receipts on the other hand are issued by the Depositary Agent appointed by the Foreign Share Issuer. In this particular case a tri-partied arrangement occurs involving the Foreign Share Issuer, the Depositary Agent and the DR holder.

Mechanics of TTDRs

Issuance

An investor can acquire a TTDR in two ways. The investor can instruct his / her broker to purchase TTDRs already traded on the local exchange or ‘create’ a TTDR by arranging the purchase or deposit of Foreign Shares in the Foreign Share Issuer’s market. Once these Foreign Shares shares are purchased they are delivered to the Depositary Agent's Custodian. The T&T broker who initiated the transaction converts the investor’s domestic currency into the corresponding foreign currency and pays the foreign broker for the Foreign Shares purchased. On the same day, the Foreign Shares are delivered to the Custodian in the foreign market, the Depositary Agent is then notified. When the Depositary Agent receives this notification, it creates and issues the equivalent TTDRs.

Cancellation

If a TTDR holder wants to sell his TTDRs, he notifies his broker. The broker will likely sell the TTDRs on the TTSE, but may alternatively surrender the TTDRs to the Depositary Agent with instructions to deliver the underlying Foreign Shares to a buyer in the Foreign Share Issuer’s market. The Depositary Agent therefore cancels the TTDRs and instructs the Custodian to release the underlying Foreign Shares.

Voting Rights

The Deposit Agreement governs the specific voting rights and protocol of the TTDR programme. The Depositary Agent will be required to prepare a voting package with an announcement of the General Meeting of the Foreign Share Issuer’s shareholders, a list of resolutions to be voted upon, and an instruction card for voting.. The Depositary Agent distributes the packages to TTDR holders, tabulates the returns and lodges its proxy at the Foreign Share Issuers General

Meeting. Several variations of DR voting procedures exist, any of which may be incorporated into the TTDR Depositary Agreement.

Trading

Following the market practices in other jurisdictions, TTDRs will be considered domestic securities, issued by a local T&T financial institution as Depositary Agent and will be subject to T&T law. While the underlying Foreign Shares that are held in a Custodian account for the TTDR Agent may be foreign securities, from the investor's point of view, the TTDR will be a domestic security. It will be quoted in TT dollars, traded on any Trinidad and Tobago Stock Exchange, and will be registered with the Commission. The TTDR ratio will be set so that prices approximate the average share price prevailing on the local stock exchange.

Benefits of a TTDR

Benefits to the Issuing Company – Sponsored Programme

In a Sponsored Programme the Foreign Share Issuer would stand to benefit from an enhanced corporate profile, opportunities to signal its commitment to the region and broaden participation by T&T investors in its economic success. Additionally, the move would improve a Foreign Share Issuer's product and service exposure both regionally and internationally.

"Making depositary receipts available in Trinidad and Tobago would further demonstrate our commitment to the region while giving local investors a chance to invest in the growth of one of the best performing financial services companies in the world". -

Peter Armenio, RBC's Head of U.S. & International Banking

Correspondingly, listing via TTDRs broadens and diversifies the Foreign Share Issuer's shareholder base improving its share valuation (due to its trading on multiple exchanges). Additionally, TTDR listings would afford local employees of multinational companies listed on foreign equity exchanges opportunities to invest in their parent company individually or via Employee Share Ownership Plans (ESOPs)

Benefits to the Trinidad and Tobago Investor

Trinidad and Tobago investors are increasingly interested in global portfolio diversification. However, obstacles such as undependable settlements, costly currency conversions, unreliable custody services, poor information flow, unfamiliar market practices, confusing tax conventions and internal investment policy may discourage retail and institutional investors from venturing outside T&T markets. TTDRs offer a simple, convenient alternative for investing internationally. Benefits to investors include:

- Portfolio diversification into international markets,
- TTDRs are denominated in and pay dividends in T&T dollars, eliminating the need for currency conversions by TTDR holders,
- International brokerage, international transaction and custodial costs are eliminated since TTDRs would be traded locally,
- TTDRs allow institutions with foreign investment restrictions to diversify its investments,
- TTDRs will be as liquid as the underlying Foreign Share because the convertibility feature exists,
- T&T nationals would be allowed to maintain some ownership of local factors of production if TTDRs of Multi-National companies, operating locally, are part of TTDR

programmes. Therefore, TTDR holders would be able to share in the potential profits when these companies issue dividends or through capital gains.

Benefits to the Trinidad and Tobago Depositary Agent

The role of a DR agent is likely to offer an attractive business opportunity.

In a Sponsored or an Unsponsored TTDR programme, the Depositary Agent will generally earn creation fees (when Foreign Shares are deposited at the Custodian and TTDRs are delivered) and redemption fees (when TTDRs are cancelled and the underlying Foreign Shares are delivered). In actively traded DR programs, where there is significant arbitrage between the home market and the DR market, the above named fees can be substantial, and can grow with the number of DRs outstanding.

Fee Revenues therefore accrue as follows:

1. Depositary Receipt Cancellation Fees
2. Depositary Receipt Issuance Fee
3. FX conversion fee
4. Global Custodian settlement fee

For these reasons, therefore the Commission expects interest among potential DR Agents in Trinidad and Tobago to provide TTDR Agent services

Key Structural Elements of the TTDR Regime

A Framework Allowing Sponsored and Unsponsored DRs

In Trinidad and Tobago, because the capital market is quite small at this time, it is unlikely that a large number of Foreign Share Issuers will immediately see the benefits of sponsoring a TTDR programme, undertaking the expense of registering TTDRs in Trinidad and Tobago and listing them on the TTSE.

There will surely be some exceptions, however. Notably, both RBC and Arcelor-Mittal have committed to sponsoring TTDR programmes that list on the TTSE.

Moreover, some of the large multinational oil and gas companies who earn substantial portions of their global profits in Trinidad and Tobago may be willing to list TTDRs on the TTSE, in order to demonstrate their commitment to the local economy and to broaden participation in their economic success among Trinidad and Tobago investors.

However the Commission believes in the short and medium-term, it will be necessary to put in place a framework that allows – and actively encourages – Unsponsored TTDR programmes. Attracting Sponsored TTDRs and listings, with the exception of RBC and possibly Arcelor-Mittal, may take years. On the other hand, if the regulatory framework can be put in place, and if local agents with adequate capabilities see the potential for this market, it may be possible to start trading five, ten or even twenty Unsponsored TTDRs relatively quickly.

Using Unsponsored TTDRs to promote T&T as an IFC

Using DRs to encourage the trading of foreign securities is a well-established strategy used by many countries – most successfully the UK and the US. Choosing to simply trade foreign securities – in the form of GDRs and ADRs – without a formal local registration or local listing is also increasingly common. Some of the international markets which have tried to build trading this way are London (with GDRs and ordinary shares on the IOB, the International Order Book market), Frankfurt (with ADRs), Hong Kong (with Nasdaq stocks) and more recently DIFX , the Dubai International Financial Exchange (with GDRs and ordinary share listings).

The concept of “unlisted” trading, usually under some kind of regulatory procedure that does not involve the consent of the Foreign Share Issuer, is also quite common in jurisdictions where multiple exchanges competitively trade the same Foreign Share issues, such as the US, India and the EU. The idea of trading “derivative” securities based on underlying securities, without a corporate issuer’s active consent, is even more well-established in options markets and index product markets around the world.

For Trinidad and Tobago, using Unsponsored TTDRs – or some other “derivative” trading vehicle that makes possible local trading without the affirmative effort of the Foreign Share Issuer – is probably the most realistic possibility to quickly build trading volumes in international securities at the TTSE.

Fee Considerations

The role of a TTDR agent is likely to offer an attractive business opportunity.

For this reason, we would expect interest among potential TTDR Agents in Trinidad and Tobago in providing TTDR Agent services

It may be difficult to encourage the entry of potential TTDR Agents into the Unsponsored TTDR market, or even into the Sponsored programme. At the inception of the TTDR programme, it may be hard to create an initial pool of inventory that can generate fees at a profitable level. It will likely take some time for the first-movers into the TTDR business in Trinidad and Tobago to demonstrate that profits can be generated.

To mitigate the above challenges, the Commission and relevant government agencies, should consider if it is feasible to provide economic incentives for potential TTDR Agents to establish Unsponsored TTDR programmes. Several kinds of incentives should be considered:

- First mover protection. Once a TTDR Agent has been chosen (Sponsored programme) or a programme has been initiated on an unsponsored basis, no additional TTDR Agents should be approved by the Commission to establish a TTDR programme for that same Foreign Share.

- Waive registration fees. Based on the number of TTDRs created, registration fees could be waived during the first year of a programme or until some critical mass of TTDRs is reached (that is likely to produce break even revenues).

Transition between Unsponsored and Sponsored Programmes

The Commission's proposed TTDR By-laws will address what will happen when an Foreign Share Issuer chooses to create a Sponsored programme, in the case where an Unsponsored programme already exists.

In the US, the standard market practice is for the various DR Agents to cooperate to avoid market confusion. Once a Sponsored programme begins for a Foreign Share, existing Unsponsored DRs for that Foreign Share are folded into the new Sponsored DR programme, to be run by the DR Agent that the Foreign Share Issuer chooses.

To compensate the Unsponsored DR Agent for its cooperation, the Foreign Share Issuer will typically agree to pay the Unsponsored DR Agent a fee based on the number of DRs transferred to the new programme. In effect, the sponsor is paying the DR cancellation fee to cancel the old

DR and create the new one. The Commission would similarly require that these termination fees and arrangements be disclosed clearly in the TTDR Agreement just as they are in DR programmes globally

In the US, this arrangement works because there are four major DR Agents (Bank of New York Mellon, Citibank, JP Morgan and Deutsche Bank). As a result, they all share an interest in a healthy DR marketplace, with the United States Securities and Exchange Commission supervising the market. In T&T, a similar market practice should take hold under the Commission's supervision.

TTDRs will be Domestic Securities

Following the market practices in other jurisdictions, TTDRs will be considered domestic securities, issued by local T&T financial institutions and subject to T&T law.

This attribute is important from an investor acceptance point of view, but the domestic treatment is critical from a regulatory point of view, for one practical reason: if TTDRs are not domestic securities, many of the largest institutional investors in Trinidad and Tobago who now hold the statutory maximum percentage of foreign securities may be forced to sell those foreign securities , specifically for example, their RBC shares (or RBC TTDRs) upon the closing of the RBTT sale. This would potentially spill an additional US$ 800 million of cash (5.7% of 2007 GDP) into the T&T economy.

Global Diversification of Risk through Investment in Locally-Traded Securities

As Trinidad and Tobago investors become more sophisticated and more aware of investment opportunities internationally, we can expect growing international portfolio diversification. Investors in every country exhibit what economists call "home bias," namely, the tendency to overweight home country securities relative to what theoretical models predict would achieve optimal international portfolio diversification. Trinidad and Tobago investors have traditionally shared this trait. Investors in smaller economies – at least smaller advanced economies with free capital flows – tend to have a larger exposure to international securities than those in larger economies.

With the introduction of TTDRs into the T&T marketplace, we can expect international diversification to intensify for two additional reasons. The first is simply the advertising effect of TTDRs being locally listed. More people will become aware of TTDRs as an investment supplement to indigenous shares and there will therefore be some uptake of these new investment products (beyond what investors are already investing abroad directly).

A second reason is that some institutional investors are currently constrained by statutory limits of foreign securities (of 10% or 20%). Once TTDRs are available, these investors will gain additional international exposure through TTDRs, when such are treated as domestic securities.

Tax Treatment of TTDRs

Under current Trinidad and Tobago regulations, dividend income paid to holders of domestic securities is exempt from income tax. Dividend income to domestic holders of foreign securities, however, is subject to taxation at the standard income tax rate of 25 percent. Depending on the jurisdiction and the existence of double-taxation treaties, the Trinidad and Tobago tax authorities will impose additional withholding tax to the withholding tax at its source, so that total withholding on foreign dividend income equals 25 percent, the standard T&T income tax rate.

The differing treatment of foreign and domestic dividend income poses a significant challenge to the success of a TTDR regime, unless TTDRs are provided with the same dividend tax exemption as other domestic securities.

In the specific case of RBTT shareholders, who will be receiving RBC shares and cash, unfavourable tax treatment of TTDR dividends may encourage the RBTT shareholders to sell RBC shares or RBC TTDRs and re-invest in other assets, causing a collapse in the TTDR programme.

The favourable taxation treatment of domestic securities was put in place, at least in part, to stimulate savings. However, once RBTT shareholders receive RBC shares, income from RBC dividends will be taxed fifteen percent at the source (by the Canadian authorities)[2] and another ten percent when paid by Trinidad and Tobago investors (to the government of Trinidad and Tobago).

Domestic tax treatment of dividends from such a locally-traded security should follow the tax treatment that is already in place for locally-traded equities, unit trusts and mutual funds. Not only will this increase the size of the local market (by adding new securities), it will also increase trading activity in the local capital market and generate fees and income for local financial market participants.

[2] Tax Treaty Convention between the Government of Canada and the Government of the Republic of Trinidad and Tobago – April 1st 1993 Article 10 Section 2 (a) and (b).

In order for this favourable domestic tax treatment to be available to TTDR investors, the Commission would register TTDRs as a local security and seek a confirming interpretation of the tax treatment by the Board of Inland Revenue, otherwise, amendments to the Securities Industry Act and Income Tax Act may be required.

Preparation for the introduction of TTDRs

Before the launch of a TTDR programme in Trinidad and Tobago, a few structural changes are required by key members of the Trinidad and Tobago financial landscape. These changes are required fairly soon.

Trinidad and Tobago Securities and Exchange Commission

It is critical that the Commission establish the appropriate regulatory framework for TTDRs. The Commission proposes to do so by establishing By-Laws. These By-laws which are to be ratified by Parliament would ensure that there is adequate disclosure and conduct among market participants relating to the issue and trading of TTDRs. The By-laws would clearly outline the requirements, responsibilities and parameters of conduct of all the critical participants namely: the Custodians, Depositary Agents, Foreign Share Issuers and Market Actors. The Commission has already drafted the said By-Laws appended to this document.

The Commission also recognises that proposing to introduce a TTDR regime in Trinidad and Tobago is an ambitious project. It is particularly ambitious due to the fact that the RBC/RBTT transaction has forced the preparation for the launch of the programme into a truncated time frame. To achieve success, substantial resources will need to be invested in public education and training. The Commission is in the process of sourcing consultants to develop and execute a marketing and communication plan around the launch of the TTDR programme.

The initial primary targets will be as follows:

- The individual investor, who may be receiving RBC shares at the time of the closing of the RBC/RBTT transaction and will need help understanding how to convert this certificate into a TTDR tradable on the TTSE,
- Active T&T stock market investors,
- Institutional investors, and
- The general public.

The objectives of the communication plan will be to educate and initiate awareness of TTDRs, while exciting investors, institutions and the public about the opportunities that TTDRs bring to the T&T capital market.

Trinidad and Tobago Stock Exchange

Once TTDRs are issued they would be traded similar to other listed securities, on a separate TTDR trading board on the TTSE. To achieve this certain structural adjustments are required.

Expanded trading hours

Currently the TTSE is constrained by its limited available trading time. The TTSE only permits a combined 12.5 hours of trading time per week as compared 35 hours in North American and other developed markets.

The current trading rules on the TTSE would need amendment to allow for a full day of trading. This would ensure there is sufficient opportunity for price adjustments to occur and for reasonable pricing parity to be maintained, while encouraging maximum liquidity and increased attractiveness to local investors.

Short-selling

Rules and the logistical capabilities permitting short-selling of TTDRs are required to encourage arbitrage by brokers that will result in additional conversion of underlying Foreign Shares into TTDRs.

Incentivised Market-making fee structure

An incentivised market-making fee structure would also be required for TTDRs, whereby parity is provided to brokers (relative to other market participants) who are willing to commit to continuous two-sided market making when the market is open. This would foster additional liquidity and the possibility of active trading in TTDRs.

TTDR Closing price adjustments

At the beginning of trading each day, the local opening price will be set to equal the official closing price in the foreign market (adjusted by the FX conversion and the DR ratio). This will ensure reasonable daily closing prices each day, even when there is no local trading.

Trading bands in TTDRs would not apply

The TTSE currently imposes a ten percent threshold limit on price movement of locally listed companies; this is done to ensure that erratic price swings do not occur during a single trading day. Such restrictions do not exist on mainstream foreign stock markets. These limits would stymie the timely adjustment of prices for TTDRs in the event that the Foreign Share on the international market experiences price movement of more than ten percent. The removal of this restriction would ensure that pricing parity is properly maintained when a price change of the Foreign Share occurs greater than ten percent.

Trinidad and Tobago Central Bank

The Trinidad and Tobago Central Bank's ("TTCB") decision on the treatment of TTDRs with regard to Pension Funds, Credit Unions and Statutory Insurance Funds is critical. These institutions collectively constitute a major segment of trading on the TTSE, therefore to ensure the success of TTDRs they must be considered eligible local investment products. The TTCB is therefore required to make a pronouncement on the treatment of these securities.

Trinidad and Tobago Board of Inland Revenue

In order for TTDRs to receive treatment similar to local securities, confirming interpretation of the proposed tax treatment by the Board of Inland Revenue ("BIR") is required. The Commission is currently in consultative talks with the BIR and awaits its interpretation.

Conclusion

The introduction of TTDRs presents a tremendous opportunity to Trinidad and Tobago on many levels.

It would spur additional trading activity on the local stock exchange, while permitting locals to diversify their portfolios internationally.

Additionally, TTDRs may perform an auxiliary service to the T&T economy as a combatant against inflationary pressures driven by excess liquidity in the financial system. TTDRs would provide an attractive vehicle for savings and investment among T&T nationals thereby absorbing additional liquidity within the economy. While this may not be a solution for the inflation problem it would be another step in the right direction.

Moreover, the if there were TTDR trading of international energy companies operating in T&T, this would provide a way for nationals to benefit directly from the increasing profitability of the energy sector, while ensuring, at least to some degree, local ownership of resident factors of production.

Given these, it becomes incumbent upon relevant stakeholders to ensure the successful launch of such a programme.