Trinidad and Tobago Securities and Exchange Commission

Remarks at IOSCO EMC Meeting
"Developing the Investor Base in Emerging Markets"

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Address by the Chairman- Ms. Deborah Thomas-Felix
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Developing the Retail Investor Base in Emerging Markets

Introduction

The global economic crisis has presented a unique opportunity for emerging market economies to engage the retail investor. Developed economies have fared poorly during this time and are currently facing the possibility of a double-dip recession. Interest rates in these economies are at an all time low providing little return to investors. Emerging economies however, while not immune to the crisis, have proven to be more stable in this environment, and continue to show signs of growth. Emerging markets can capitalise on this, using this favourable environment to encourage the active participation of the retail investor in the capital market.

A retail investor, also known as an individual investor or a small investor, is one who buys and sells securities for his or her personal account, rather than for a company or organization.

I will highlight today the benefits that retail investors bring to the capital market and suggest possible approaches to developing the retail investor base.

The Role of the Retail Investor

The retail investor has the potential to contribute in no small measure to the financial market. The retail investor can:

- **Provide stability and liquidity to financial markets – at its simplest, a liquid market is one in which it is always possible to execute a transaction, be it a sale or a purchase. In a liquid market, an investor is assured that he can sell his investment when needed, at the prevailing market price. Retail investors can number in the thousands – in the US for example, retail investors numbered 91 million in 2007 and owned equities of approximately US$4.9 trillion. In addition, a retail investor is more likely to buy and sell over a shorter period than would an institutional investor, which pursues a buy-and-hold policy. The presence of the retail investor ensures there is always a ready market for a product;**

- **Enhance the price discovery mechanism, which is the mechanism by which the price of an asset is determined on the market through the interaction of buyers and sellers. The large number of retail investors allows for an asset to be accurately priced and in this regard, the retail investor contributes to the development of the capital market;**

- **Stimulate economic growth – they provide investment capital which firms are able to access for investment. In addition, investors earn returns on their investment which they either reinvest or spend within the economy, further driving economic growth via the multiplier effect;**

- **Give both government and business some measure of confidence – a necessary condition for economic activity – as both are assured that they will be able to meet their funding needs as and when needed.**

Developing the Retail Investor Base

Developing the retail investor base should start with domestic investors.

Foreign investors are more likely to enter a country if domestic investors are already present in the market because this suggests to the foreign investors that the market is viable. With the presence of an active domestic investor base, foreign retail investors should be pursued to further add to the pool of available capital as well as to introduce added competition into the market.

A domestic retail investor base can develop if the local private sector is encouraged, perhaps through taxation policies and other facilitative measures by the government, to engage in productive activities. Domestic retail investors can also be encouraged by the opportunity to have some form of ownership in local enterprises and developmental projects.

The participation of Retail investors in the financial market can be constrained by among other things;

- **taxation policies,**
- **a lack of choice in terms of products and instruments &**
- **an overall lack of sophistication of investors.**

These are some of the areas that need to be addressed in order to develop an adequate investor base in emerging markets.

I would now examine two areas which are critical to the development of the retail investor base. These two areas are investor confidence and investor education.

Investor Confidence

Building investor confidence is especially important in the current global environment where confidence is generally low and there have been many instances of fraudulent activities with respect to investor funds. One of the best ways to improve Investor confidence is through an effective regulatory regime.

Regulation is of particular importance to the retail investor mainly because retail investors are the most vulnerable investor group and require more protection than institutional investors.

These investors may lack basic knowledge of financial matters, making them ill equipped to participate in the financial market, with all its risks and pitfalls. In addition, many retail investors do not have the capacity and resource to perform due diligence with respect to investments.

Therefore an effective Regulatory regime which includes active surveillance, monitoring, enforcement and adequate mechanisms such as transparency, accountability and corporate governance, is very important in building investor confidence and ultimately broadening the investor base.

Investor Education

In disclosure-based regulatory systems it is of paramount importance that the issuer discloses all information pertinent to the investment so that the investor can make informed decisions. Financial literacy assumes an important role in this environment.

Despite the fact that information is available, many retail investors do not have the financial prowess to process this information and to make the right investment decision.

The complexity of the modern financial landscape coupled with the global financial crisis has caused us to recognize financial literacy as an important life skill. We are well aware that low levels of financial literacy can result in costs for the financial markets and the real economy.

While effective regulation cannot eradicate all the risks that exist in the market and indeed we do not want to eradicate all risks, we do want to eradicate systemic risks. It is imperative that the retail investor be able to, as much as is possible, protect his interests and manage risk. To do so the investor needs to be made aware of the risks and pitfalls in the market and of his rights as an investor, Investor Education is a very useful tool in this regard and will benefit not only the individual investor but the entire financial sector.

Role of Stakeholders in Investor Education

All relevant stakeholders can play an active role in providing investor education. Governments can provide financial literacy at the school level. The private sector, in their role as providers of investments, can ensure products are simple with transparent fee structures.

The regulators can potentially play the biggest role by providing advice on financial issues and coordinating the programmes that others may provide. The stock exchange can also play a role in this area. In Argentina, for example, the stock exchange provides an introductory course on the capital market to the public.

The programme is free and is offered over a four-week period once a year. It covers the capital market, financial instruments, regulation and portfolio management. The Australian stock exchange provides a similar service, offering a comprehensive investor education program.

The Role of Stakeholders in Promoting Retail Investor Participation

Regulation and investor education are important in an efficient and transparent market but they do not guarantee retail investor participation in the financial market. Other factors should be considered and each stakeholder has an important role to play.

Government

- **Implementing financial sector reforms – this will serve to enhance the stability of the financial system and promote the development of the capital market;**

- **Ensuring macroeconomic stability and economic development – foreign investors even at the retail level, are encouraged by an economy that is both stable and viable. This is borne out by the flight of capital to emerging markets post crisis as these economies continue to show signs of growth even as the developed economies are facing the possibility of a double-dip recession;**

- **Forming public-private partnerships between relevant stakeholders, including regulators, self-regulatory organisations and financial institutions, while developing and forming consensus on an investment promotion and investor education strategy.**

Private Sector

- **Developing specialist trading platforms – a trading platform is the software that allows investors and traders to place trades and monitor accounts.**

  Trading platforms will, in most cases, incorporate software for market analysis, allowing traders and investors to chart the markets. This can also facilitate cross-border trading, adding to the pool of potential investors;

- **Strengthening the corporate governance regime of market actors – how companies are directed and controlled is important to investors and to promoting their confidence in a company. Corporate governance will include full disclosure, adequate company law and commercial codes as well as creditor protection.**

The relevant regulators can ensure adequate corporate governance by companies, though it is in a company's interest to implement this itself;

- **Introducing new products/instruments – it is important to recognize that different investors would be interested in a range of products having varied risk levels. Instruments that would appeal to the retail investor, taking note of his risk preference and lack of sophistication, should be developed and promoted.**

<u>Regulator</u>

- **Encouraging the development and efficiency of financial intermediaries – liquidity is the result of financial intermediation on the secondary market. Issuers produce financial assets, such as bonds, and investors purchase these financial assets. Financial intermediaries are responsible for bringing these two actors together. Financial intermediation therefore gives retail investors greater access to securities. One method to promote efficiency in this sector is through the formulation and promulgation of a code of conduct for these institutions.**

Stock Exchange

- **Developing the secondary market – the secondary market is the market where an investor can buy a security directly from another investor. Initially, securities are issued in the primary market and are then traded on the secondary market. Securities issued on the primary market are priced before issuance, which price the market must accept.**

  On the secondary market, prices are determined by the interaction of supply and demand among investors. It is therefore important that a secondary market exists to facilitate the trading of securities beyond their initial issuance.

Conclusion

Investors are the lifeblood of a vibrant capital market which contributes in no small measure to economic growth. In this current global environment where many individuals are feeling left behind in terms of prosperity and growth, the capital market presents a viable option for individuals and retail investors do have a vital role to play in the growth and development of the market in emerging economies.

Thank you.

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