Diversifying Bond Market and its Challenges in Fiji

Amit Alvin Prakash

***Abstract*—**In Fiji the financial system comprises of financial institutions, financial markets and the clearing and settlement systems. The capital market deals with financial instruments that mature in excess of one year and have a contractual claim. To diversify the Capital market, the then Government of Fiji introduced Viti bonds in 2012. Primarily the Viti bonds mostly targeted retail investors and was allocated between the ranges of $1000 to $200,000. Compared to the infrastructure bonds, there has been a limited subscription of Viti bonds. Therefore, this paper proposes to investigate why Viti bonds have been under subscribed. In doing so, the paper takes an exploratory approach in contributing to the limited studies on Viti Bonds. Be that as it May, the findings of this research could be instrumental in updating or reshaping the financial literacy programs tailoring to enhance greater participation in the bond market.

Keywords—Capital Market, Diversification, Financial System, Viti Bonds.

I. INTRODUCTION

FIJI Islands is a cluster of approximately 330 islands of which about a third are inhabited. The total land area is 18,333 sq. km with two major islands; Viti Levu (10,429 sq. km) and Vanua Levu (5,556 sq. km) comprising of 837,271 people with diverse cultural backgrounds. Moreover, Fiji lies in the Oceania region of the Southern hemisphere. Fiji is an upper middle income economy with Gross National Income per capita of $4830. The household composition is proportioned to 51% urban dwelling and 49% rural dwelling.

Fiji was a colony of the Great Britain for 96 years prior to gaining independence on 10th October, 1970. Fiji has a Westminster parliamentary system and was asserted a republic in 1987. The country's greatest challenge has been recuperating from the political instabilities. In 2016 Fiji's Gross Domestic Product (total monetary value of goods and services produced) was approximated to be US$4.402 billion (constant 2010 US dollars). The economy's highest foreign earner is tourism.

The Fijian financial system encompasses financial institutions, financial markets and the clearing and settlement systems. These financial institutions are 6 commercial banks, 2 life insurance companies, 7 general insurance companies, 4 credit institutions, 9 registered foreign exchange dealers, Fiji National Provident Fund (FNPF) and 2 money changers. Moreover, the players in the financial markets are South Pacific Stock Exchange (SPSE) licensed stock brokers and licensed unit trust brokers.

The legislations empowering Reserve Bank of Fiji (RBF) to administer the financial system are the RBF Act (1983) and the RBF (Amendment) Decree 2009. In addition, there are Banking Act (1995), Exchange Control Act (Revised 1985), Insurance Act (1998) and Capital Markets Decree (2009). Furthermore, the total gross assets of Fiji's financial system have steadily escalated for the past 15 years (Fig. 1). The total gross asset of Fiji's financial system was $16.4 billion in 2015 compared to $14.5 billion in 2014 [6]. A few notable expansions in the last 5 years had been the entry of new commercial banks; Bred Bank (2012) and HFC Bank (2014). Moreover, Kontiki Finance Limited was sanctioned to operate as a credit institution in 2015.

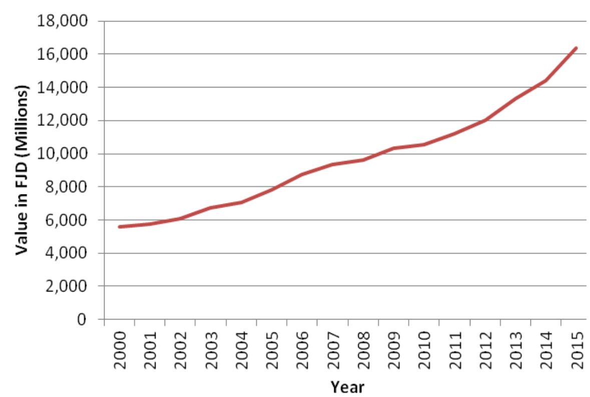

Fig. 1 Total gross assets of the financial system

II. FIJI'S BOND MARKET

The Capital market deals with financial instruments that mature in excess of one year and have a contractual claim. In Fiji, the capital market is made up of equities market, unit trust markets and bonds markets. Bonds market dominates the composition of capital market ahead of equities and unit trust markets (Table I). Bonds are debt securities where the bondholder is entitled to receive fixed interest at a specified interval with principal payment and interest at maturity. Furthermore, bonds are issued by corporations, statutory

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bodies and government to sustain financial commitments. Intuitively, government bonds are default risk free implying that the financial obligations are always honored. In Fiji, the issuer of government bonds is Fijian government and register of bonds is RBF.

TABLE I
COMPOSITION OF THE CAPITAL MARKET (FJ$ MILLIONS)

	2011	2012	2013	2014	2015
Equities Market	744	816	768	907	1074
Unit Trust Market	117	123	142	174	205
Bonds Market	3025	2972	2930	2932	3087
Total	3386	3911	3840	4013	4366

The issuers in the bond market are: Fiji Sugar Corporation (FSC), Housing Authority of Fiji (HA), Fiji Electricity Authority (FEA), Fiji Development Bank (FDB) and Fiji government. The Fiji Development Bank floated its first bond issue with Central Monetary Authority of Fiji (CMA) in 1976 while; Fiji Electricity Authority entered the bond market in 1979. Government of Fiji issues infrastructure and Viti bonds respectively. Reference [4] outlined that Fiji's financial sector is generally stable but there are issues; (1) lack of risk diversification, (2) over 40% of total financial system assets captured by FNPF that hampers capital market development; (3) restriction in FNPF's ability to invest offshore and engage in international diversification. Furthermore, diversified financial markets hedge financial incompetence's and strengthens efficiency of capital allocation [3].

III. CAPITAL MARKET DEVELOPMENT AUTHORITY OF FIJI (CMDA)

RBF formalized a Capital Market division in the Financial Institutions department in 1991. The Asian Development Bank (ADB) in 1995 reviewed development of capital market in Fiji. An essential disclosure was that Fiji has a well developed financial sector but infant capital market with limited activity. The report also acknowledged limited savings and investment instrument opportunities in Fiji. Thus, as part of the review process ADB provided technical assistances on three occasions; 19th June 1986, 21st December 1989 and 23rd December 1993. The recommendation via technical assistance was for formation of Capital Market Development Authority.

In light of the above review process, CMDA was established under the CMDA Act (1996) and formalized operations in 1998. CMDA was tasked with regulating Fiji's entire capital market and enforcing legal requirements of Unit Trust Act (1978), CMDA Act (1996) and its accompanying Regulation and Rules (1997). However, on 13th August 2009 CMDA operations were consolidated into RBF due to heavy cost of operating CMDA that was estimated to be FJ$1.6 million in 2010. It was anticipated by the government that the merger would reduce operating cost by 50% or more.

IV. DIVERSIFYING BOND MARKET

Retrospect to the traditional bonds, the Fijian government diversified the bond market in 2012 with introduction of Viti bonds. Initially the minimum amount of investment in Viti bonds was $1000 with maximum of $100,000. Later the maximum amount was pegged to $200,000. The benefits of investing into Viti bonds are (1) interest on bonds are quarterly earned and exempted from income tax, (2) default risk free, (3) the return on bonds are competitive and (4) transferable whereby the bondholder can sell part or all of the holding bonds with exemption for stamp duty. Moreover, Viti bonds assured returns of 4% per annum for 5 years maturity, 4.5% per annum for 7 years maturity and 5% per annum for 10 years maturity.

The rationale for Viti bonds was to; (1) provide an alternative investment option to investors, (2) encourage retail investors participation and (3) cushion the rise in liquidity with the first batch payment of pensioners under the new age based pension scheme by FNPF. In February 2012, FNPF had anticipated that there will be a pay out of about FJ$100 million in both lump sum and pension options under the new age based pension scheme. However, the Fijian Government Debt Report acknowledged that the cumulative response to Viti Bonds had been FJ$22.2 million till the 2015 fiscal year and stated a need for greater public awareness on Viti Bonds (tailor made for pensioners and retail investors) [5].

The response to the new capital market instrument was anticipated to be highly favorable. However, as illustrated in Fig. 2 the holding of Viti bonds has been under subscribed for respective years of allocation. The high liquidity, as a result of FNPF payout, may have boosted the Viti bonds issued in 2013. Even though arguments may be in favor that there has been moderate to strong response in selected years, the pivotal realistic is the *under subscription*. Thus, curiosity arises to investigate factors restricting full subscription of the safest capital market instrument. This research explores the challenges encountered in Fiji despite the financial literacy initiatives by the RBF. Moreover, the impediments identified will reshape and advance financial literacy programs for Fiji.

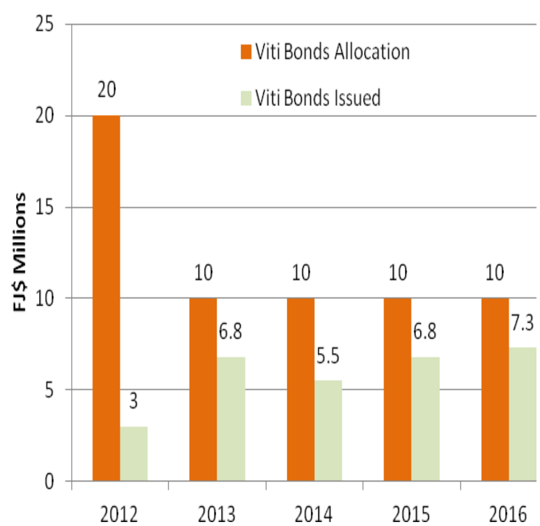

Fig. 2 Response to Viti Bonds Issue

V. CURRENT FINANCIAL LITERACY INITIATIVES OF THE RBF

Reference [8] reported that in the next two decades approximately two billion in the world will participate in the formal financial system. On the same note, reference [1] disclosed that the financial markets are becoming accessible for small investors with new range of financial products and services. To ensure Fijians are in par with the global financial innovations RBF has undertaken a number of initiatives. A milestone was the establishment of the National Financial Inclusion Taskforce in February of 2010. Subsequently, the financial literacy mascot 'Vuli the Vonu' was unveiled. Vuli signifies school in iTaukei language whilst Vonu is a turtle. A turtle is smart (responses quickly to overcome obstacles in continuing the journey), strong (persevere all types of wealth) and steady creature.

National Financial Literacy Strategy was documented that coordinated the framework for development and delivery of financial literacy programs complementing financial inclusion. Moreover, financial education was integrated into the Fiji school curriculum from 2013. As part of the money smart projects it was mandatory for secondary school students to have a bank account. The efforts for a financially sound society even extended to the financial literacy radio and television programs.

VI. CHALLENGES IN FIJI

The Fijian capital market has been further diversified with Viti bonds and the initiatives of the RBF have been complementing the financial development. However, it is evident that the response to the new capital market instrument has been unfavorable relative to the anticipated response. An integral challenge is the market awareness. Most potential investors in the market are unaware that such bond is available for retail investors. This opposes the RBF efforts in disseminating financial literacy information. Thus, literature disclosed that the response to savings instruments are no longer confined within the workplace programs or captured by the school curriculum. The response is behavioral biased whereby, financial literacy programs need to be behavior and population specific as there is no one shoe that fits all.

Furthermore, investor retention as other financial institutions offers similar investment securities with competitive rate of return. The flexibility provided by Viti bonds in terms of redeeming the bond at the discretion of the bondholder with a fee of FJ$20 contracts outstanding bonds. Bondholder's cash back bonds at par value from RBF to meet financial obligations. Intuitively, the pacific thinking of being risk averse shadows the benefits from Viti bonds. Fijians wish not to participate in investment game and settlement for returns from commercial bank deposits. The uncertainty restricts investors from optimistic response to Viti bonds. This is consistent with [3] findings that the Asian bond market has remained underdeveloped due to conventional status quo (bank finance is dominant).

The proposal for external investors in the domestic bond market is hindered with inadequate supporting infrastructure. Moreover, to secure Viti bonds the investor needs to be in attendance at Financial Markets and Institutions division at RBF.

VII. CONCLUSION

Viti bonds are the safest debt instrument tailor made for retail investors. However, the mentioned challenges in the subsection VI limit highly favorable response. An important underpinning is that diversifying the market does not necessarily constitute positive market participation. The preliminary element is to assess the complementing behavior, information dissemination techniques and infrastructure. Prior to broadening the bond market, the Fiji government ought to embark on scrutinizing the opposing forces that led to consolidation of CMDA. On the same note, 'once bitten, twice shy" as findings from CMDA consolidation could provide valuable insights for Viti bonds. Furthermore, the financial literacy programs need to be revised to population specific. There also exists a need to formalize an electronic platform (over the counter) for trading of bonds. Thus, an electronic platform will escalate the capacity of bond holders expanding to foreign investors.

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