



# Leveraging the Jamaican Diaspora for Development

Prepared for:

23 November 2003

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Contract: LAG-00-99-00010-00

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USAID/Jamaica is seeking to leverage the financial resources of the Jamaican Diaspora to support local economic development initiatives. The Diaspora community, which now exceeds the size of the local population, provides significant capital to Jamaica through remittances, direct foreign investments, and tourism. In remittances alone, nationals living abroad transferred more than US\$1.3 billion to Jamaica, representing over 12 percent of GDP, in 2002.<sup>1</sup> The Jamaican Diaspora remains an untapped development resource that could serve as a powerful development tool.

International development agencies can play an important role in helping Jamaica leverage the wealth of its Diaspora. This money can be harnessed for development use by any one of three tools: (1) Development Bonds, (2) Certifications of Deposits, and (3) Remittance Bonds. USAID can support these public and private sector initiatives and redirect the capital raised by them to finance development projects such as infrastructure and small and medium enterprises. USAID's role would include technical assistance on these projects as well as possibly providing a credit enhancement through the Development Credit Authority.

**Development Bonds.** Development bonds are generally state-level supported bonds that are typically purchased by the members of the Diaspora to support the economic and infrastructure development of the home country. The most successful model has been the State of Israel Bonds, which has raised more than US\$25 billion since its inception in 1951. The Development Corporation for Israel, a NASD-registered broker/dealer, issues more than US\$1 billion per annum in securities with 5-10 year terms. The bonds are backed by the full faith and credit of the Government of Israel.

Jamaica is likely to find Development Bonds on the Israeli scale to be cost-prohibitive. Any public bond issuance in the US will be subject to Securities & Exchange Commission filings and regulations, which is both time consuming and very costly. In fact, there is even some disagreement within Israel as to whether the State of Israel Bonds are worth the cost of issuance. Early research, however, suggests that finance and legal fees for a private placement of a Development Bond would be reasonable given less onerous filing requirements.

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<sup>1</sup> Multilateral Investment Fund of the Inter-American Development Bank. "Sending Money Home: An International Comparison of Remittance Markets." Washington, DC: February 2003.

The most likely scenario for a Development Bond offering from Jamaica would be through a large commercial bank. The bank would issue a US\$100 million bond with a term of 5 to 10 years through a private placement with select Jamaican investors in the US and elsewhere. The proceeds of the funds would be used to finance local infrastructure projects, from waste water and sewerage to the restoration of downtown Kingston. It is not clear, however, what interest rates investors would find acceptable given the risks involved with a commercial Development Bond deal; this would be the first of its kind.

**Certificates of Deposits.** In 1998, India offered a new product, Resurgent India Bonds, which were marketed as Certificates of Deposits (CDs) to avoid the application of strict and expensive SEC regulations. The offering was extremely successful, raising US\$4.2 billion, more than double the initial goal.<sup>2</sup> The success of the bonds is even more remarkable in light of the fact that interest rates on the instruments were higher than what India's credit rating would suggest they should be. The CDs were sold through Indian and foreign commercial banks that specialized in providing services to Indian expatriates.

The use of CDs is an exciting financial tool to consider. A large commercial Jamaican bank could develop new savings products for the Jamaican Diaspora with the proceeds, again, being used to support development goals. The bank has several possibilities: (1) offer CDs over the Internet without active marketing and solicitation in the US, (2) offer CDs over the Internet with active US marketing, or (3) offer CDs through bank affiliates in the US. The last two options require approval from US authorities, but would still be more cost-effective than the regulatory filing associated with Development Bonds.

Despite the attractiveness of CDs, the legality of such financial instruments remains unclear. The offeror of the Resurgent India Bonds, the State Bank of India, did not file a registration statement with the SEC nor did it receive a no-action letter relief from the SEC recognizing the possibility of an exemption. Instead, the State Bank obtained clearance from banking authorities in which they had planned to market the product. In 2002, however, India decided against offering its next Diaspora Bond in the US after discussions with American regulatory officials.<sup>3</sup> It is not entirely clear as to what led to the decision.

**Remittance Bonds.** An emerging financing trend has been the use of Remittance Bonds where banks issue US-denominated bonds collateralized by worker remittances. When a bank receives a wire transfer to the home country from the United States, it deposits a portion of the dollars into an offshore account that serves as a pass-through by which the pooled assets become standard securities backed by those assets. The bonds generally have five year terms and are sold at investment grade. To save on filing and registration costs, the bonds are sold through private placement.

Remittance bonds are considered attractive by investors since they are relatively low risk. The bonds are securitized in US dollars so there is no foreign exchange rate risk. And since the funds are collateralized before conversion to local currency, investors are insulated from political and regulatory changes. With the reduction in risk, most remittance bonds are rated investment grade, which substantially lowers borrowing costs. Countries such as Mexico, El Salvador, Panama, Egypt, Honduras, and Turkey are actively using or considering the use of remittance bonds.

One of the banks most active in remittance bonds has been Banco de Brasil. In August 2001, the bank issued US\$300 million worth of bonds with five-year maturity, using as collateral future yen remittances from Brazilian workers. The terms of these bonds were

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<sup>2</sup> Chander, Anupam, 2001. "Diaspora Bonds." *New York Law Review*, Volume 76, Issue 4: p 1066.

<sup>3</sup> Chander, 1074.

five levels higher than Brazil's sovereign rating. In December of the same year, the bank securitized its US receipts, raising US\$450 million through the issuance, 50 percent more than the initial US\$300 million that was planned.<sup>4</sup> The bond sale is more impressive considering that the offering was made during the Argentine crisis.

In the Jamaican context, a large commercial bank could issue remittance bonds to finance development initiatives. The bank would be the first financial institution to specifically allocate the bond proceeds towards local development. Other banks that have used remittance bonds have done so to support commercial operations. Initial research suggests that the bond issuance would have to be at least \$50 million (standard issuance is US\$100 million) to make it cost-effective. Banks can securitize approximately 20 percent (conservative estimate) of the remittance transfers that occur through the bank.

**Development Credit Authority.** The Development Credit Authority (DCA) can play an important role in leveraging the Jamaican Diaspora for development by providing an incentive for banks to use the funds to support local development. Banks that are currently utilizing these financing tools to raise capital have directed the proceeds for commercial uses, which do not necessarily support development objectives. USAID can offer a DCA guarantee to encourage banks to use the bond sale towards economic growth and infrastructure development.

It should be noted, however, that DCA cannot support projects with currency mismatches. As such, a bond guarantee cannot be provided for Development Bonds or Certificates of Deposit. DCA, however, can potentially participate in these issuances by providing guarantees on the underlying loan portfolio that will be created by the bond issuance. Any such arrangement would take time to structure as there are significant risk management issues that DCA would need to manage appropriately.

**Recommendation.** Given the possible financing options (Development Bonds, Certificates of Deposit, and Remittance Bonds), Remittance Bonds appears the most attractive solution for leveraging the Jamaican Diaspora. Securitization of remittances provides banks with lower cost of funds given the lower risk, while also isolating investors from foreign exchange and political risk. Moreover, the cost of structuring a remittance bond is reasonable when compared to the other financing tools.

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<sup>4</sup> Banco de Brazil. 2001 Management Report. Brasilia: Banco de Brasil, 2001.

## Summary of Financing Options Leveraging the Jamaican Diaspora for Development

	Development Bond	Certificate of Deposit	Securization Bond
Financial Structure	A certificate of debt issued by a bank in order to raise funds for development and infrastructure projects.	A negotiable certificate issued by a bank in return for a deposit of money for a term of up to five years.	A debt instrument that is securitized by pooled assets.
Target Client	Institutional/Individual Investors	Individual Investors	Institutional/Individual Investors
Proposed Type of Offering	Private Placement	Public Offering	Private Placement
Strengths of Structure	Allows the bank to raise large sums of money for development-oriented projects.	Allows the greater Jamaican Diaspora to participate in the development of the country.	Allows banks to acquire capital at a lower cost given the security's collateralized assets.
Associated Risks	Foreign exchange risk given the bonds are issued in US\$ and revenue source is in local currency.	Foreign exchange risk given the bonds are issued in US\$ and revenue source is in local currency. Legality of CDs offered by banks with limited retail presence remains ambiguous.	Main risk is associated with the steady stream of remittance transfers; concerns include: ability of workers to send money home, switch in wire transfer method, or return to home country.
Role of DCA	DCA does not directly support projects with currency mismatches. However, DCA may be able to provide a loan portfolio guarantee to support the bond issuance.	DCA does not directly support projects with currency mismatches. However, DCA may be able to provide a loan portfolio guarantee to support the bond issuance.	DCA may be able to provide a bond guarantee, provided certain program and risk management conditions are met.
Cost of Issuance	Extremely high; cost is 1-3% of issuance (based on rough estimates by JPMorgan).	Low/Moderate depending on legal clarification.	Moderate; cost is 0.5-2% of issuance (based on rough estimates by Mayer Brown Rowe & Maw)
Recommendation	A development bond is probably not the best option given the high cost of issuance.	A study on the legality of the certificates of deposit is required before a recommendation can be made.	A remittance bond is the easiest option given the market's acceptance of the bonds and its lower risk profile.