Joint IFI Needs Assessment on Local Capital Market Development

EGYPT – JORDAN – MOROCCO – TUNISIA

Deauville Partnership

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Contents

List of abbreviations and acronyms

ADMDI	Arab Debt Market Development Initiative
AfDB	African Development Bank
ALM	Asset-liability management
AMF	Arab Monetary Fund
AUM	Asset under management
BVMT	Bourse des Valeurs Mobilières de Tunis
CBE	Central Bank of Egypt
CBJ	Central Bank of Jordan
CCP	Central Counterparty
CD	Certificate of deposit
CDVM	Conseil Déontologique des Valeurs Mobilières
CP	Commercial paper
CRA	Credit rating agency
CSD	Central Securities Depository
DMU	Debt management unit
DVP	Delivery-versus-payment
EBRD	European Bank for Reconstruction and Development
EFSA	Egyptian Financial Services Authority
EIB	European Investment Bank
ETF	Exchange Traded Fund
FDI	Foreign direct investment
FSAP	Financial Sector Assessment Program (IMF and World Bank)
FX	Foreign exchange
GCC	Gulf Cooperation Council
ICSD	International central securities depository
IFI	International Financial Institution
IMF	International Monetary Fund
IPO	initial public offering
IR	Investor relations
IsDB	Islamic Development Bank
IT	Information technology
IVT	Intermédiaires en Valeurs du Trésor
JSC	Jordan Securities Commission
MCDR	Misr for Central Clearing, Depository and Registry
MENA	Middle East and North Africa
NPL	Non-performing loan
OECD	Organization for Economic Co-operation and Development
OFID	OPEC Fund for International Development
OPCVM	Organisme de Placement Collectif en Valeurs Mobilières
OPEC	Organization of the Petroleum Exporting Countries
PD	Primary dealer
PDD	Public Debt Department
PPP	Public–private partnership
REIT	Real Estate Investment Trust
ROE	Return on exchange
RTGS	Real time gross settlement
SDC	Securities depository centre

SEMED	Southern and eastern Mediterranean
SLF	Securities lending facility
SME	Small and medium-sized enterprise
SOE	State-owned enterprise
SPV	Special Purpose Vehicle
STICODEVAM	Société Tunisienne Interprofessionnelle de Compensation et de Dépôt des Valeurs Mobilières
SVT	Spécialistes en Valeurs du Trésor

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Executive summary

The objective of this report is to provide an instrument that can be used to further the development process for capital markets in the southern and eastern Mediterranean (SEMED) region. While each of the four partnership countries exhibits a particular set of macroeconomic and capital market characteristics and conditions, they do share common themes in terms of the bottlenecks and impediments they face in developing their local capital markets.

A set of sequenced recommendations to address these common issues is outlined and prioritised based on an assessment of how critical the measure is for the development of local capital markets, while the sequence presented also takes account of the impact the measure will have, the ease of implementation and the timeline needed to introduce the measure. In total, 16 recommendations are made: 10 short-term, three medium-term and three long-term recommendations.

A key recommendation to emerge is the need for strong coordination at the national level. The government can and should play a central role in each country. Political commitment to and government ownership of the overall development process is essential. The capital market development process is not linear and requires a series of reforms and interventions across a wide range of markets and topics. The need for a well-coordinated and inclusive approach, involving all the relevant ministries, authorities, regulators, market participants and development agencies, is the most important requirement identified. Addressing capital market development needs in the four partnership countries also requires a shared long-term vision. The authorities and the market community at large have the will to propel the capital markets forward and have already been active in the implementation of various measures in this regard. They have engaged extensively with the various mission teams and have helped to shape the priorities for reform and the recommendations.

In light of the current state of local capital market development in the four partnership countries as well as the near-term funding needs of the respective governments, the sequencing of security market reforms should focus initially on further optimisation of the public debt management strategy. A well-functioning government securities market will: (i) support the development of private financial markets by providing a benchmark yield curve as a reference for pricing other financial assets; (ii) support the development of an institutional investor base for capital markets; (iii) enhance the efficiency of monetary policy by building a transmission mechanism and facilitate its implementation by providing indirect monetary policy tools; and (iv) strengthen the economy’s resilience to adverse shocks. The capital markets in the four partnership countries provide a platform through which the aforementioned could be achieved efficiently, with a multitude of positive synergies for the banking system and private sector players.

More developed markets have set standards and benchmarks that have now become accepted as international best practices for custody arrangements, as well as clearing and settlement infrastructure, corporate governance, disclosure and enforcement. These can be seen as minimum requirements in terms of what investors expect in order to be comfortable to invest in a market, and therefore adherence to such standards is a recommendation that should be prioritised immediately.

Improving small and medium-sized enterprises' (SMEs') access to capital market funding is a topic that even more developed markets are struggling with and which features prominently also in the recommendations presented here. The capital markets of the four partnership countries face structural issues, especially in relation to how they can stimulate entrepreneurial activities and ultimately employment growth. Presently, capital markets provide a venue for investors to trade the shares of only the established listed companies but they also play a limited role in financing investments, especially for young and growing businesses. Reforms on the supply side will require a long-term perspective, as they will involve changes to the ownership structure of the corporate sector and the overall business culture, especially in relation to the reluctance among the owners of family-owned businesses to relinquish control over their companies and adhere to disclosure requirements. The prevalence of state-owned enterprises and cross-shareholdings contribute to the concentration of decision-making power and distortions in market behaviour. In the short term, interventions should be focused initially on addressing some of the specific impediments identified. Local stock exchanges and financial authorities should ensure listing requirements and tax frameworks accommodate SMEs that wish to access capital market finance. Properly functioning specialised market segments for the listing and trading of SME securities can play an important role here also.

There is evidence of pent up domestic and international investor demand waiting for a more stable political environment and improvements to the legal and regulatory environment in the four partnership countries. Local corporates are most likely reluctant to implement large-scale investments for the same reasons. Once the near-term political milestones are passed, the existing imbalance between supply and demand forces will come to the fore. To bring these forces into balance requires a combination of structural reforms and a strong and stable supply of investible assets, including both equity and debt instruments.

Improving the functioning of the domestic money markets – especially the reliability of the interbank deposit reference rate – is essential. Money market rates should be rigorous and representative of market activity if they are to fulfil their function as a reference rate. Developing securities lending facilities as well as the appropriate legal framework and mechanisms for short selling and derivatives should be prioritised.

The reality is that banks will continue to play a dominant and important role in the traditional financial intermediation process in these four SEMED countries, but they also need to recognise and fulfil their roles and responsibilities as facilitators in the mechanics of capital markets, by intermediating between the buy and sell sides.

I. Introduction

Subsequent to the G-8 Finance Ministers' Meeting in Marseille in September 2011, the International Financial Institutions (IFIs) concerned jointly agreed on eight focus areas of activity under the Deauville Partnership. The European Bank for Reconstruction and Development (EBRD) and the Arab Monetary Fund (AMF) were tasked to lead the module on the development of local currency capital markets in four transition countries: Egypt, Jordan, Morocco and Tunisia. The intention was for the IFIs to implement technical assistance support in a coordinated manner according to each institution's mandate and expertise to work with the four partnership countries towards developing their local currency and capital markets.

The IFIs involved agreed that this support, provided under the Deauville Partnership, will be combined with technical assistance provided by the AMF and the International Monetary Fund (IMF), along with other institutions, under the Arab Debt Market Development Initiative (ADMDI)[1], which aims to improve the efficiency and enhance the functioning of the public and corporate debt markets in countries that are members of the AMF.

Within this context, assessment missions visited Tunisia (July 2012), Jordan (August to September 2012), Morocco (March 2013) and Egypt (January to February 2014). The objective of these missions was to provide a holistic overview of the current state of the local currency capital markets in each of the four partnership countries. In close consultation with local authorities and market participants, these assessments identified key bottlenecks for the further development of the capital markets in each country and outlined a sequence of measures to address these. The missions have resulted in four independent country reports that cover the full spectrum of capital markets, including the securities markets, banking sectors, money markets, equity markets, as well as foreign exchange (FX) and derivative markets. This allowed the IFI community to identify the key areas where their respective interventions will have the most meaningful impact. A number of projects have already been initiated off the back of these assessments, such as:

- ✓ Capital market development action plans and implementation roadmaps (Jordan and Tunisia)
- ✓ Improvements to the clearing and settlement infrastructure (Egypt and Tunisia)
- ✓ Development of derivative laws (Morocco)
- ✓ Support for small and medium-sized enterprises (SME) to improve their access to finance (Morocco and Tunisia)
- ✓ Development of strategies to expand the investor base, to attract foreign investors in government bonds (Morocco).

The objective of this report is to synthesise the findings of the four country reports into a single document that can serve as a flagship report to guide capital market development in the region. This report highlights cross-cutting themes and identifies and prioritises short-, medium-

[1] See Annex 1 for further details on the key recommendations and themes that emerged from this work.

and long-term recommendations, with the aim of informing the regional capital markets development strategy and subsequent action plans.

The report is organised as follows: Section II provides a regional overview of the current state of the local currency capital markets (including the key bottlenecks that exist); Section III outlines a sequenced set of recommendations to improve the functioning of the capital markets on a regional basis; Section IV lays out in more detail the main themes that have emerged at a regional level; and Section V lists the country-specific recommendations. Annexes to this report include the key recommendations and themes from the ADMDI missions and a general summary of the roles and responsibilities of a debt management unit (DMU).

II. State of local capital markets

While each of the four partnership countries exhibits a particular set of macroeconomic and capital market characteristics and conditions, common themes are evident in terms of the bottlenecks and impediments to the development of the local currency capital markets.

This section provides a summary of the state of the capital markets in Egypt, Jordan, Morocco and Tunisia along nine spheres: macroeconomic environment, banking sector, government debt, Islamic finance (sukuk), corporate bonds, equity markets, investor base, market infrastructure and corporate governance.

1. Macroeconomic environment

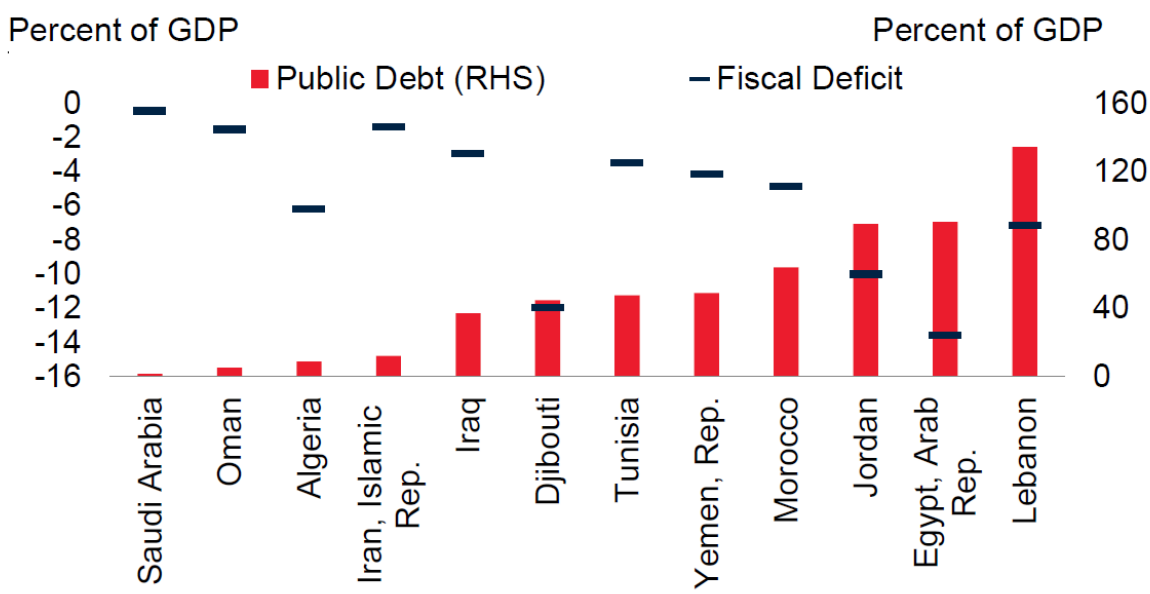
Table 1: Summary of key macroeconomic indicators, 2011-15

	2011	2012	2013	2014	2015*
Egypt					
Real GDP growth rates (%)	1.8	2.2	2.1	2.2	4.0
Budget deficit (as % of GDP)	-9.8	-10.6	-14.5	-13.6	-11.3
Current account balance (as % of GDP)	-2.6	-3.9	-2.4	-0.8	-3.3
Level of international reserves (US$ billions)	26.4	15.2	14.5	16.3	-
FDI (as % of GDP)	1.27	1.41	1.33	1.33	-
Jordan					
Real GDP growth rates (%)	2.6	2.7	3.3	3.5	3.8
Budget deficit (as % of GDP)	-12.7	-10.5	-14.7	-9.3	-5.4
Current account balance (as % of GDP)	-10.2	-15.2	-11.1	-12.9	-6.6
Level of international reserves (US$ billions)	10.7	5.3	9.34	9.5	-
FDI (as % of GDP)	5.06	4.82	5.21	5.2	-
Morocco					
Real GDP growth rates (%)	5.0	2.7	4.4	2.9	4.4
Budget deficit (as % of GDP)	-6.7	-7.4	-5.2	-4.9	-4.5
Current account balance (as % of GDP)	-8	-9.7	-7.6	-5.8	-5.0
Level of international reserves (US$ billions)	20.6	17.5	19.3	20.4	-
FDI (as % of GDP)	2.4	2.4	2.9	2.9	-
Tunisia					
Real GDP growth rates (%)	-1.9	3.7	2.3	2.8	1.0
Budget deficit (as % of GDP)	-3.3	-4.8	-6.0	-6.7	-5.7
Current account balance (as % of GDP)	-7.4	-8.2	-8.4	-6.6	-8.5
Level of international reserves (US$ billions)	7.5	8.7	7.7	9.1	8.2
FDI (as % of GDP)	0.9	3.9	2.1	2.2	-

Sources: IMF and World Bank Group for 2015 forecast (*)
FDI: foreign direct investment; GDP: gross domestic product

Macroeconomic conditions in the four partnership countries continue to face significant challenges. The security situation has worsened considerably in the region and the drop in oil prices is a significant adjustment. For the partnership countries, the positive effect of lower oil prices – in terms of fiscal balances and current account deficit – are largely offset by a combination of lower remittances, spillovers from tensions in neighbouring countries (not only the influx of refugees but also the continued reduction in tourism receipts as security concerns prevail), as well as the long-standing structural constraints of high unemployment, reduced foreign direct investment (FDI) and lower exports. Despite some improvement, fiscal and external imbalances persist and much remains to be accomplished to put the four economies on a sustainable growth path while at the same time addressing the short-term risks. A key risk is the failure to deliver on expectations of substantial improvements in governance and accountability.

Figure 1: Public debt and fiscal deficit, 2014



Sources: IMF and World Bank Group

Growth rates remained subdued and broadly flat in 2014.[2] Cyclical weaknesses of government revenues combined with a rise in public spending to alleviate social pressures have increased overall budget deficits and levels of public debt. Subsidies, primarily of energy and basic foodstuffs, continue to play a significant role and remain a challenge despite the introduction of reforms to reduce subsidies in some countries. Decreases in capital expenditure negatively impacted economic growth and employment. Increased government borrowing constrains domestic liquidity and is crowding out the private sector.

There is continued reliance on external loans and grants for fiscal stimulus and to bolster foreign currency reserves. Inflationary pressures, which were relatively subdued in 2011 and

[2] Except in Morocco where growth was negatively impacted by significant reduction in agriculture output in 2014.

2012 due to weaker local demand, a fall in international commodity prices and relatively stable currencies, increased in 2013, driven in part by imported inflation and an easing of monetary policy. Lower commodity prices and weak global growth have kept inflationary pressures moderate. Exchange rate regimes are either fixed or tightly managed, which helped stabilise the banking system but could become overvalued, hurting external competitiveness and eroding reserves.

2. Banking sector

Table 2: Banking sector summary information, 2012-14

Banking sector	Egypt			Jordan			Morocco			Tunisia		
	2012	2013	2014	2012	2013	2014	2012	2013	2014	2012	2013	2014
Total Assets/GDP	93.0	-	-	177.0	na	na	125.0	-	-	95	98.9	100.8
Number of banks	40.0	40.0	40.0	26.0	26.0	25.0	29.0	-	29.0	21.0	21.0	22.0
Loan/deposit ratio	48.1	44.1	41.1	71.4	68.6	63.7	104.0	-	-	112.0	112.0	113.0
NPL ratio	9.8	9.3	8.5	7.7	7.0	5.6	5.0	5.8	-	14.9	16.5	15.7
NPL coverage ratio	97.1	99.8	98.0	69.4	77.0	77.6	68.0	-	-	45.7	56.4	57.9
Capital adequacy	14.9	13.7	13.0	19.0	18.4	18.4	12.3	-	-	11.8	8.2	9.6
ROE	13.9	14.5	14.5	8.6	9.9	11.0	11.9	-	-	7.2	2.9	11.2

Sources: IMF and World Bank Group
GDP: gross domestic product;; NPL: non-performing loan; ROE: return on equity

The banking sectors have remained stable overall and did not experience a significant level of withdrawals.[3] The sector is relatively large with total assets to GDP ranging from 90 to 180 per cent. Banks are reliant on domestic deposit funding but penetration is limited. With the exception of Tunisia, sector concentration is high in terms of total deposits and liquidity. Banks continue to use large parts of their balance sheets to fund governments through the purchase of government securities. Bank lending is focused on large corporate borrowers, leading to another form of concentration risk. Lending to the SME sector remains limited.

Liquidity conditions have tightened with reliance on central bank interventions rather than interbank money markets. The latter are shallow with transactions mostly in shorter maturities and ongoing counterparty credit risk concerns. Maturity and interest rate mismatches are large and would create significant risks in more volatile conditions. Hedging instruments for both interest rate and exchange risk management are not well developed. Exchange rate risks are largely contained by the low volatility of the domestic currencies and the presence of various types of bank restrictions on FX transactions.

[3] The exception is Tunisia where the banking sector suffered a significant recession in 2011 and public banks require significant capital injections (estimated at 1.7 per cent of GDP).

There is a lack of meaningful term structure of interest rates, which causes a lack of reliable pricing benchmarks. Coupled with the lack of long-term fixed-rate funding, this is limiting banks' ability to provide long-term domestic lending at fixed rates. Some banks lack sufficient capital to support new lending while absorbing additional provisioning due to asset quality deterioration, and there is a need to ascertain with accuracy the levels of capital adequacy ratios and non-performing loans (NPLs).

3. Government debt market

The fixed-income market in the four partnership countries is relatively small with market size to GDP ratios ranging from 10 to 44 per cent. With the exception of Morocco, government debt securities tend to dominate the local fixed-income market. Treasury bills (T-bills) and Treasury bonds (T-bonds) are commonly used and issuance is mostly in local currencies. Banks tend to hold most government debt securities until maturity.

Activity is confined to the primary market. The secondary market is small and illiquid and is hindered by the lack of repurchase agreement (repo) activity. Primary dealer (PD) systems are in place (except in Jordan) but their effectiveness is limited as short selling is mostly not practiced (or in some cases not permitted) and securities lending facilities (SLFs) do not exist. PD obligations do not include quoting of predefined benchmark maturities (reference rates) but rather for specific securities.

In the absence of a liquid secondary market, the yield curve does not fulfil its function of providing a reference for the pricing of other financial assets. The absence of a sovereign yield curve is a significant impediment to the development of the capital markets in the four partnership countries. This has contributed to a lack of mark-to-market of the fixed-income portfolios of institutional investors and created a misleading perception of asset price stability.

To varying degrees, the authorities have improved their approach to managing public debt and the functioning of their debt management operations,[4] but they still don't fulfil their role in developing a reliable yield curve, which is a pre-requisite for the development of other fixed-income instruments. The role of managing the public debt is complicated by local factors. The stability, regularity and transparency of issuances and information dissemination require further attention. The process is negatively impacted by the insufficient reliability and predictability of the forecasted amounts of government receipts and expenditures. Any meaningful progress on resolving technical issues and addressing the bottlenecks will require close coordination between the different stakeholders involved in the management of public debt and the issuance of government securities.

[4] See Annex 2 for typical roles and responsibilities of a debt management unit (DMU).

4. Corporate bond market

With the exception of Morocco, the corporate bond market in the four partnership countries remains small and in some cases almost non-existent. Major impediments include the historic role that banks play in financing corporates; the absence of a meaningful yield curve; the lack of a secondary market; and the perception of cumbersome issuance, registration, listing and disclosure requirements.

Depending on the country, several authorities are typically involved in the issuance process for corporate bonds, such as the comptroller of the companies (companies' law), the capital market authority (securities law), the exchange and local CSDs (listing and registration regulations), and central banks (banking law) if the issuer is a commercial bank. There is a perception of overlap and lack of clarity resulting from the interaction of several different laws, regulations and governing bodies.

The length of time it takes to apply for and receive approvals is typically three to four months, thereby exposing corporate issuers to potential disadvantages due to rapidly evolving market conditions. Shelf registrations and fixed-time regulatory responses are not common practices. There is little distinction between public offers versus private placements in terms of regulatory requirements, and issuers do not have available the full range of bond structures, such as hybrids or convertible bonds.

Underwriters function on a 'best efforts' basis, which has negative implications for the development of a secondary market. Book building is not common. The coupon is set early in the process for marketing purposes and little discussion happens later on to determine the yield. This problem is compounded by the lack of a transparent benchmark yield curve, which could provide guidance for estimating the likely funding costs to issuers.

Deeper secondary market liquidity would expand the investor base and, by reducing the liquidity premium, help lower the overall funding costs, but this linkage is not recognised by stakeholders.

5. Islamic finance (sukuk)

The four partnership countries are at an early stage of developing a sukuk market. Only Jordan has put in place the full regulatory framework for the issuance, registration, listing and trading of sukuk.

6. Equity markets

Despite the relatively large number of listed companies, market capitalisation and trading values are concentrated in a small number of large companies. Certain sectors tend to dominate, such as construction, banking and financial services, and telecommunications. Large portions of listed shares are owned by individuals associated with listed firms, as well as foreign strategic investors who do not typically engage in trading activities.

Table 3: Equity markets, 2014

Equity markets indicators	Egypt	Jordan	Morocco	Tunisia
Market cap as % of GDP for each exchange	24.3%	75.8%	50.0%	20.9%
Market cap in US$ billions	70.0	25.6	53.5	9.3
Number of listed companies	247	236	74	77

Source: Stock exchanges' websites

Markets were fairly liquid and deep in the years leading up to 2008, but have not managed to match these levels in terms of liquidity and market capitalisation since. Primary market activity remains constrained by the small number of initial public offerings (IPOs). The limited supply of new IPOs reflects low valuation levels as well as long-standing structural issues that include a disclosure-shy culture and a lack of full understanding of the benefits of listing. Competition from the banking sector makes funding through the stock market relatively unappealing. Private equity funds are not sizable enough to have a meaningful impact on the development of an IPO pipeline and the privatisation process is generally on hold.

Many foreign investors exited stock markets in the four partnership countries since the global financial crisis and they only return opportunistically, reflecting macroeconomic imbalances as well as insufficient free floats, small market capitalisations, and lax disclosure and corporate governance requirements. Valuations in terms of projected price-to-earnings ratios may be considered relatively high compared to regional markets or to other emerging and frontier markets. The sectoral mismatch between the underlying economies of the four partnership countries and listed firms represented on the stock exchange limits international investor appetite to a certain extent as emerging market portfolios seek a broad exposure to a country's economy. Consequently, the role of foreign investors in secondary market activity is limited.

Demand for equity in Jordan and Tunisia comes mainly from local retail investors and institutional investor participation in the stock market is limited, reflecting a fund management industry that is still relatively small and in need of further reform and development. In Egypt there is a balanced mix of retail and institutional investors, while in Morocco institutional investors are the dominant investors in the equity market. The collapse of share prices since the global financial crisis and the onset of the Arab Spring severely affected investor confidence and raised questions about the enforcement capabilities of regulatory bodies.

The prolonged period of low trading volumes since the global financial crisis has affected the financial viability of brokerage firms and some have considerable volumes of non-performing client loans on their books. Brokerage firms tend to focus on trade execution and do not provide higher value-added services. As a result, investment decisions and market turnovers by local retail investors are mostly based on market sentiment and informal information. There is also a general lack of financing instruments and practices such as short selling, securities borrowing and lending, Exchange Traded Funds (ETFs) and Real Estate Investment Trust (REITs), which impacts the development potential of equity markets.

7. Investor base

In general, the investor base for government securities in the region is dominated by banks and, to a lesser degree, pension funds. The insurance sectors remain small (except in Morocco), while professional asset management is largely absent. Mutual funds and collective investment vehicles are at varying degrees of development but in general do not play a significant role. See Section IV.7 for a more detailed summary of the specific characteristics of the investor base in each country.

8. Market infrastructure

With the exception of Tunisia, where securities transactions are not settled on a full 'delivery-versus-payment' (DVP) basis, and Egypt, where settlement performed by the Central Bank of Egypt (CBE) for T-bills and CBE notes is not currently based on DVP, the legal and regulatory environment for primary and secondary markets in the four partnership countries seems to be generally sound and the infrastructure is at an acceptable level for today's market needs. There is, however, considerable room for improvement on a number of fronts, including full asset segregation. The legal framework for clearing and settlement is typically set out in several laws and regulations of varying hierarchies that include central banks, ministries of finance, capital market regulators, the exchanges and the CSDs. As a result, special care should be given to avoid overlapping or contradicting regulatory requirements and to streamline oversight and banking supervision processes.

All securities are immobilised or dematerialised and are transferred in book-entry form. The local Central Securities Depository (CSD) holds ownership records for all securities issued by the private sector while there are cases where government and central bank securities are registered in the book-entry systems of the central banks.

9. Corporate governance

Attempts to promote listed companies with international investors, as well as the onset of the Arab Spring, has heightened awareness and appreciation of the need to reform corporate governance requirements. Listed companies are subject to several authorities' regulatory powers and there are inconsistencies and contradictions in terms of the enforceability of corporate governance codes. In Jordan, the code is applied on a 'comply-or-explain' basis, while in Egypt, Tunisia and Morocco the codes remain voluntary.

A prevailing view in the four partnership countries is that the powers of stock exchanges relative to corporate governance oversight and enforcement are much more limited than those of the securities regulators and that the listing agreement may not have sufficient legal traction in this regard.

While the level of awareness among board members and executives of good governance practices has evolved, the implementation of governance codes is often perceived by the corporates from a purely compliance-oriented perspective. Investor engagement will be important to demonstrate that market participants have certain expectations of their investee companies in terms of their governance arrangements, with risk premiums applied in cases of deficiencies.

III. Recommendations

This section presents a set of recommendations. These are prioritised based on how critical the measure is for the development of local capital markets, while the sequence presented also takes account of the impact the measure will have, the ease of implementation and the timeline needed to introduce the measure. Within this context, short-term actions are critical and should be worked on immediately – these are seen as low-hanging fruit in terms of impact, ease of implementation and timeline needed. Medium-term actions require a longer timeline to implement but can be worked on in parallel with the short-term recommendations. Long-term classification reflects the reality that these measures, despite being important in their own right, are achievable only over a longer time horizon and when other issues have been addressed.

It is important to stress that the capital market development process, especially at the regional level, is not linear and that the classification presented below and the many inter-linkages between the recommendations presented as well the timelines required can be debated at length. The classification presented here is a best effort to present a sequenced set of recommendations applicable at the regional level. Some of the recommendations (or certain aspects of them) are already being worked on by the local authorities, market participants and IFIs in the partnership countries.

Short-term recommendations

1. National capital markets committee

Establish a committee headed by the prime minister and including the relevant high-level officials from central banks, ministries of finance, ministries of industry and trade, capital market regulators, exchanges and depositories, as well as private sector representatives. The committee is to be tasked with formulating and implementing a national action plan to develop the local currency capital markets. More specifically, it will be tasked with harmonising stakeholders' interests, ensuring buy-in from the key stakeholders, and coordinating technical assistance provided by IFIs. Although the day-to-day management of activities can be delegated, having it headed by the prime minister would ensure political support and coordination at a national level in the formulation and implementation of the national action plan.

Rationale and impact

The establishment of such a task force is deemed to be of critical importance for the successful development of capital markets. With the appropriate political will and the support of local market participants, the task force can be established in a timely and effective manner. If established and managed effectively, the task force will ensure the political support and the high-level coordination needed to achieve meaningful capital market development.

2. Government debt management strategy

Develop a formal government debt management strategy that articulates operational goals and an implementation roadmap. The strategy should also aim to further develop the PD systems by enabling non-banks to act as PDs. PD agreements should be revised to allow for enforceable obligations to quote two-way prices for buying and selling securities as well as to quote reference rates. Capitalising on recent successful international bond issues from the region, the strategy should also incorporate an external public debt programme to build international issuances that would evolve in sync with its local debt programme. The strategy should also include an investor relations (IR) function and provide for the development of investor relationship capabilities.

Rationale and impact

A formal government debt management strategy improves benchmark issuance by increasing size and maturity, and streamlining auction frequency and the transparency of the auction calendar and results. This would facilitate the emergence of a viable yield curve; a crucial step in developing the local currency capital market, including the corporate bond market. Developing an international public debt programme in a controlled and cautious manner will help reduce pressures on the domestic funding market, with positive implications for the cost of borrowing and the crowding out of the private sector. Providing incentives for PDs to provide liquidity in the secondary government debt market would help create reference rates and encourage the development of the corporate bond market. It would also attract international investors and encourage local retail investor participation. Developing IR will become increasingly important as the market develops.

3. Custody arrangements and infrastructure

Review custody arrangements for securities at the local CSDs and local custodians to ensure investor protection is adequately provided for in cases of enforcing claims as well as asset segregation. Review and benchmark existing DVP models (clearing, settlement and other depository infrastructure) against international best practice, and propose changes where appropriate to ensure real DVP exists, to facilitate the functioning of clearing banks and to enhance business continuity plans. Local CSDs should be consolidated where more than one exists. The feasibility and appropriateness of transforming existing settlement guarantee funds into Central Counterparties (CCPs) should be explored in certain cases. The legal framework for clearing and settlement is often set out in different pieces of legislation that involve more than one local authority. This fragmentation could result in contradictory requirements and lapses in regulatory oversight, introducing potential systemic risk issues.

Rationale and impact

The effectiveness of custody arrangements greatly impacts investors' appetites for local securities. Global custodians look to protect client assets via arrangements with local custodians and CSDs. Ensuring that appropriate custody arrangements and infrastructure are in place will have a significant positive impact on the attractiveness of the local capital markets to domestic and international investors.

Systems used to settle and clear financial market transactions should be secure, cost-efficient and convenient. They should offer DVP, provide for standard account segregation, and ensure settlement finality and final registration of ownership. The DVP model seeks to eliminate settlement risk from securities transactions by ensuring that sellers relinquish ownership of their securities if, and only if, they receive full payment and vice versa. Settlement finality is an important aspect. There are three essential elements in a DVP transaction: (i) final and irrevocable delivery of securities, (ii) final and irrevocable delivery of funds, and (iii) simultaneous exchange.

As such, clearing and settlement systems need to have a clear legal basis and be subject to regulatory oversight and have the necessary capacity to process required trading volumes within the chosen settlement cycle. Weaknesses in the securities settlement systems can be a source of systemic disturbance, not just to securities markets but also to the wider financial system.

4. Corporate bond and sukuk issuance

Provide appropriate incentives to corporates and banks to issue bonds. Review the existing regulatory framework for the issuance, listing and trading of corporate bonds (securities law, companies' law and banking law – where the issuer is a bank) and recommend changes to streamline the issuance procedure. Regulatory response times to applications to issue and list corporate bonds need to be shortened and the approval process needs to be streamlined between the local authorities involved (regulators, comptroller of the companies, central banks, exchanges and depositories).

Put in place the legal and regulatory environment for the issuance, registration, listing and trading of sukuk, including clauses for underperformance and default. Allow for consistency in taxation between government and corporate bonds and sukuk. Establish a Central Sharia Council to streamline conventions and parameters of sukuk structures. Benchmark the local framework against international best practices. Include sukuk issuance in the government debt management strategy and facilitate the first sovereign sukuk issue.

Rationale and impact

Banks need to address maturity and interest rate mismatches. Corporates are heavily reliant on bank debt, which introduces concentration issues for both borrower and lender. There is a need for sovereign sukuk issues to establish a template that others can follow. There is considerable pent up demand for investing in Sharia-compliant financial instruments by retail and institutional investors in the four partnership countries, the region and internationally. Issuers, both governments and corporates, would be able to tap into a pool of funds that is not easily accessible otherwise and efforts should be made to facilitate retail investor access to both corporate bonds and sukuk.

5. Access of small and medium-sized enterprises (SMEs) to capital market finance

Facilitate improved access to finance for SMEs by diversifying funding sources, including through the capital markets, such as accessing foreign capital via private equity or listed equity routes and the bond markets (privately or publically placed). Interventions here should be focused initially on working on the specific impediments in each country that impact the ability of SMEs to access finance. Local stock exchanges and financial authorities should ensure listing requirements and tax frameworks accommodate SMEs that wish to access capital market finance. The establishment of properly functioning specialised market segments at each of the existing four exchanges in the partnership countries for the listing and trading of SME securities should be promoted. The demand side will benefit from the growth of a private equity sector as well as the creation of SME investment funds and SME-friendly collective investment vehicles. In time, linking the regional exchanges in the form of order-routing could be an initial step towards the regional integration of securities markets; new segments could in time be set up as one regional board with four entry points, or as four local boards with harmonised rules that could be linked later.

Rationale and impact

SMEs play a significant role in the four partnership countries in terms of their contributions to GDP and workforce absorption. SMEs have difficulty accessing bank financing due to collateral issues, many being in the informal economy. Listing and trading securities of SMEs on junior market segments would help develop a pipeline of listings for the main boards and encourage venture capital and private equity investments into SMEs. There is significant momentum and attention attached to this topic and it should be a priority for the authorities in each country given the role the SME sector plays in each.

6. Stock market corporatisation

Corporatise/demutualise the ownership structures of exchanges by turning them into public shareholding companies.

Rationale and impact

A corporate ownership structure would help to promote the introduction of new business lines, improve revenue streams at the existing exchanges, and allow for a wider inclusion of stakeholders. It would also enable the exchanges to aggregate liquidity across borders by entering into strategic alliances with each other or with other exchanges in the region via cross-holdings. Depending on the level of political support and the legislative change process in a country, this recommendation can have a significant impact in the short term.

7. Disclosure and corporate governance

Review disclosure requirements for listed companies and corporate bond issuers as well as the effectiveness of enforcement measures. Benchmark these against international best practice and propose changes where appropriate. Enhance IR capacity of listed companies including publishing financials in English. Encourage the establishment of an Investor Relations Society. Map out a gradual move of corporate governance requirements from a voluntary or 'comply-or-explain' basis to a mandatory one, prioritising the phasing-in of the governance code in coordination with other local authorities. Iron out inconsistencies and contradictions in different legislations and harmonise enforcement. As mentioned previously, IR functionality should be added to the responsibilities of the government's debt management unit (DMU).

Rationale and impact

Initial and ongoing disclosures, as well as 'use of funds' compliance, will impact the fairness and transparency of capital markets and investor confidence. Upgrading listed companies' abilities to communicate their equity stories to current and future investors would help widen the investor base (both local and international), increase liquidity and improve corporate governance. A key issue for the local capital markets has been investor confidence, especially as it pertains to issues of governance and related party transactions. International investors tend to place a premium on the existence of a governance code in accordance with international best practices and its enforceability by regulators.

8. Enforcement

Enhance enforcement capabilities of regulatory and oversight bodies, and streamline complaints procedures.

Rationale and impact

The ability of regulators and exchanges to inspect, investigate and enforce actions is critical for the development of the local currency capital markets and to gaining and maintaining local and international investor confidence. Efforts should be made to ensure the main capital market regulatory institutions are able to recruit, remunerate, train and retain talent. Any impediments in terms of local cost constraints should be resolved. Political support should be provided where needed.

9. Local issuer and investor education

Educate companies on benefits of listing as well as adherence to disclosure and corporate governance best practices (such as reduced risk premiums and lower cost of capital). Investor education should focus on broad capital market issues as well as trading violations, benefits of collective investment schemes and financial planning.

Rationale and impact

Most local investing tends to be retail, and tends to be sentiment driven. Companies rely on bank loans to meet funding needs, neglecting other capital market alternatives.

10. Money markets, instruments and tools

Encourage the further development of money markets by addressing counterparty credit risks among banks and the increased use of secured money market transactions. Set up SLFs as well as the legal framework and mechanisms for short selling and derivatives. Work with central banks to create Sharia-compliant instruments for Islamic banks to manage liquidity.

Rationale and impact

Encouraging banks to provide liquidity to one another would make the banking system more resilient and less reliant on central bank intervention. It would also help in the establishment of pricing benchmarks and address liquidity concentration issues. The ability to borrow and lend securities helps increase liquidity in the government debt secondary market and helps to further develop the PD systems. It also enables investors to hedge (including for interest rate and exchange risk management), thereby increasing the attraction of the local capital market. There is a need to increase liquidity while minimising volatility.

Medium-term recommendations

1. Investment funds, pension schemes and insurance sector

Facilitate the growth of bond, sukuk and mutual funds and introduce new collective investment schemes that monetise sectors such as REITs and ETFs. Provide incentives to develop the private pension industry and restructure existing pension schemes to ensure future viability. Encourage professional management of insurance company investments and the introduction of life insurance policies (offering, distribution, education) to increase demand for longer-dated securities.

Rationale and impact

The local investor base is largely retail. Pension schemes are mostly government run. There is a need to catalyse the emergence of an independent professional asset manager class. Insurance company investments tend to be concentrated within certain sectors and securities and mismatches are common. Investing in longer-dated securities would address this and help the emergence of a viable yield curve. This would also encourage the development of intermediary capabilities and value-added services, including research.

2. Public–private partnerships (PPPs) and Project Bonds

Put in place the legal and regulatory framework for PPPs where lacking, and facilitate the establishment of an infrastructure development fund. Encourage private sector participation in financing infrastructure projects by introducing a framework for the issuance of Project Bonds.

Rationale and impact

PPPs alleviate pressures on government budgets and allow for increased transparency in procurement and project management. An infrastructure development fund would help meet funding requirements for projects in such sectors as energy, water and transportation.

Including retail investors in the fund would increase citizens' participation in the economic development of their country. A future listing of the fund on a local exchange would help deepen the capital market.

3. Equity issuance

Increase issuance from well-recognised and diversified private sector entities and privatisations. Emphasise large market capitalisations and high free floats. Incentivise family-owned businesses to list.

Rationale and impact

A small number of large listings dominate market capitalisation, with sector and liquidity concentrations evident. Lack of economic diversification of listed firms diverts international investor attention. Recent market declines necessitate regaining local investor confidence with listing of viable, growth-oriented companies.

Long-term recommendations

1. International investors

Conduct road shows to market local capital markets to international investors.

Rationale and impact

International investors will be encouraged by improvements in transparency, infrastructure and secondary market liquidity. Their participation helps diversify the local investor base.

2. International indices

Engage with international index providers to upgrade local capital markets from frontier to emerging market status.

Rationale and impact

Upgrade requirements and provide a checklist that the local capital markets can benchmark against as they reform and further develop. An upgrade to emerging market status increases international investor awareness of the local market and attracts allocations by index fund investors.

3. Credit rating agencies (CRAs) and research functions

Corporates should be encouraged where appropriate to seek an external credit rating in order to generate interest in their name. Brokerage houses, banks and independent research companies should produce quality fixed-income and equity research that will improve the visibility and attractiveness of the local capital markets.

Rationale and impact

External CRAs can facilitate investor appetite for and assessment of local issuers (specifically non-government issuance). Investors (especially international institutional investors) will often require an external credit rating as part of their investment criteria. Introducing external CRAs and improving research functions will help to establish minimum criteria and in time will allow local practice to align itself more fully with international best practice in fixed-income analysis.

IV. Common themes

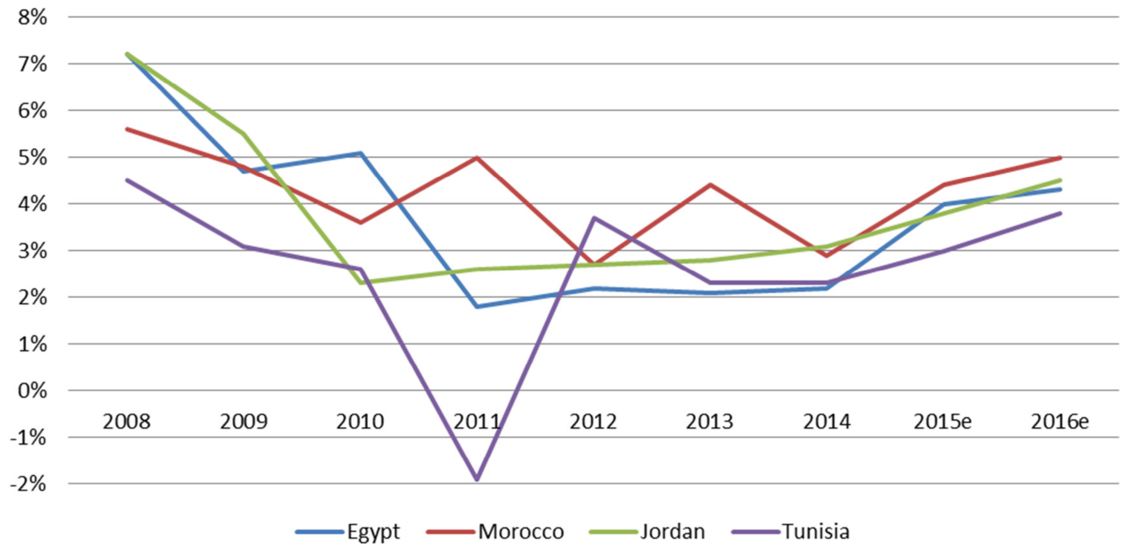
1. Macroeconomic environment

Recent developments

The macroeconomic framework for both fiscal and monetary policies strongly influences capital market development priorities and growth potential. A stable macroeconomic environment gives investors and savers confidence that the real value of their assets will be preserved, thus ensuring adequate demand for local currency-denominated debt. It also encourages the corporate sector to increase investment and as a result expand the supply side of the market by issuing long-term bonds. This enables investors to achieve their savings objectives. Finally, a market-based monetary framework sets the foundation for a robust financial sector that can intermediate savings efficiently to realise appropriate risk-return structures for both borrowers and savers.

Following the start of the global financial crisis and the onset of the Arab Spring, the macroeconomic conditions in the four partnership countries faced significant challenges, owing to a combination of internal and external factors. The negative economic conditions faced since 2011, namely regional economic and political turmoil and a weak global economy, continue to have a big impact on the four countries. Key external drivers of economic growth – such as tourism receipts, exports of commodities and manufactured goods, FDI and remittances – continue to be negatively impacted.

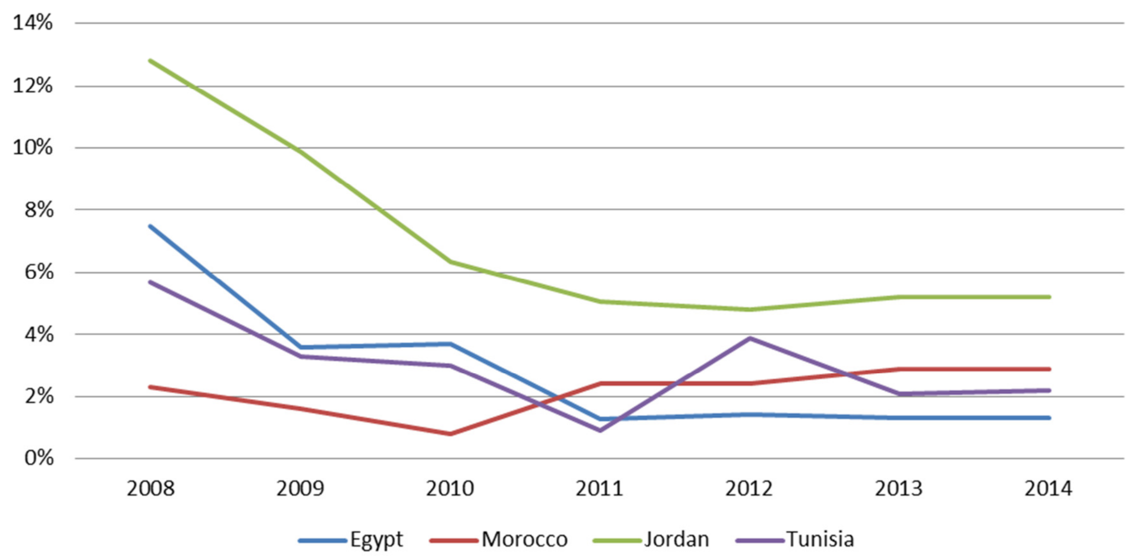
Figure 2: Regional – economic growth comparisons, 2008-16



Source: IMF
Note: Data for 2015 and 2016 are estimates.

To address these challenges, authorities in the four partnership countries undertook several measures and policy initiatives exhibiting common approaches. However, the credibility of macroeconomic and fiscal policies is critical to creating appropriate market expectations, the most important being perceptions of inflationary risks, exchange rate risks, and commitment to fiscal discipline.

Figure 3: Regional comparison of foreign direct investment (FDI) (% of GDP), 2008-14



Source: IMF

Although some improvements in key indicators have been observed, fiscal and external imbalances continue and much remains to be accomplished to put the four economies on a sustainable growth path.

While each country has its own particular set of local circumstances, common macroeconomic themes have been observed. These include:

- Economic activity has slowed down, in terms of GDP growth rates. Growth has been affected by the worsening security situation and political turmoil in the region and efforts need to be made to address risk premiums assigned to this. The impact of global economic conditions has also been strongly felt in terms of imported inflation and weak export markets. These adverse conditions have contributed to the fiscal and external imbalances.

- Cyclical weaknesses of government revenues combined with a rise in public spending intended to alleviate social pressures led to increased budget deficits as a percentage of GDP as well as the ratio of public debt to GDP. This is negatively impacting capital expenditure and, as a result, economic growth and employment. The cost of government borrowings has increased.

- Fiscal deficits are expected to remain elevated with rising financing gaps. Heavy reliance on borrowing from the domestic banking sector to finance government expenditures is prevalent. This has led to a decrease in domestic liquidity and a crowding out effect on the private sector as well as increases in the cost of finance. Future refinancing needs of governments may exacerbate the situation.

- Current account deficits have increased as a percentage of GDP. Increases in import bills, especially related to energy, contributed to this as well as shortfalls in FDI. Declines in foreign reserves and pressures on local currencies emerged and defensive measures were taken by central banks.

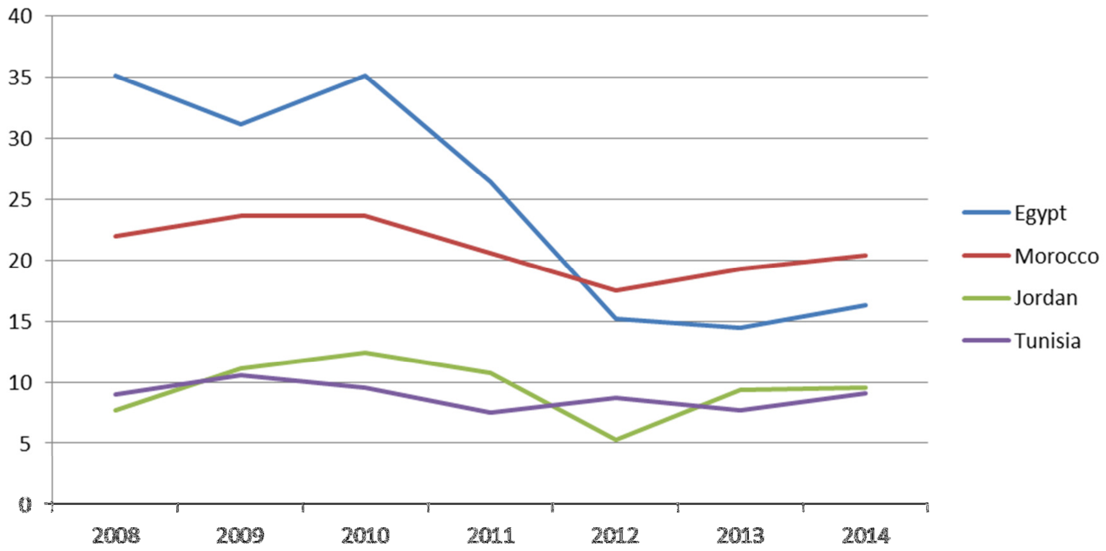
- Although inflationary pressures were relatively subdued in 2011 and 2012 due primarily to weaker local demand, a fall in international commodity prices and relatively stable currencies, the four countries have seen a steady increase in prices throughout 2013 driven in part by imported inflation and an easing of monetary policy. Housing prices have risen. Low oil prices have helped contain inflationary pressure more recently.

- Subsidies, primarily of energy and basic foodstuffs, remain a challenge despite the introduction of reforms and the positive impact of lower oil prices on the cost of subsidies. In the short term, governments are attempting to rationalise subsidies for leakages and maintain an intricate balance between fiscal restraint and the need to manage the political and economic expectations of restive populations. Efforts are being made to phase out energy subsidies.

- Reliance on IMF Stand-by Arrangements and Precautionary and Liquidity Lines led to attempts at gradual fiscal consolidation (short- to medium-term plans) to reduce public sector financing needs and lower public debt, while balancing this against recession and social unrest. Efforts are also being made at increasing tax revenues and improving tax administration.

- Reliance on external bilateral loans and grants, including financial support from the Gulf Cooperation Council (GCC), the European Union, the United States and other countries, as well as multilateral development organisations has eased immediate funding concerns, provided governments with headroom for fiscal stimulus to promote growth and bolstered foreign currency reserves. If grants were excluded, deficits would have increased dramatically.

Figure 4: Regional comparison of the levels of international reserves (US$, billions), 2008-14



Source: IMF

Outlook

- Much will depend on developments in the security situation and improved political stability. The short-term economic outlook remains challenging. Stimulus packages consisting mainly of additional social and investment spending may increase growth and create jobs in the short term but need to be reversed to avoid deepening macroeconomic vulnerabilities.

- Unemployment rates remain high and authorities are attempting to focus on creating jobs to help reduce pressures to provide more subsidies. Large portions of the economies in the four partnership countries remain informal and although this has sustained growth and prevented severe drops in overall economic activity, capital market development would substantially benefit from attracting segments of the informal economy into the formal economy.

- Exchange rate regimes are either fixed or tightly managed. Although this has helped stabilise the banking system and retain confidence in the national economies and asset values, preventing dollarisation or euroisation, this may complicate macroeconomic management and slow down capital market development in the medium to long term. Exchange rates could become overvalued, hurting external competitiveness and eroding reserve buffers. Foreign investors may exercise caution when considering investing in such markets.

- A key risk for the economies of the four partnership countries and to social cohesion is the failure to deliver on expectations of substantial improvements in governance, accountability and policy conduct following the Arab Spring. State economic institutions continue to play a major economic role, and adherence to international best practices in terms of governance and transparency is essential for future political stability.

- Future fiscal expansion should prioritise public investment and move away from current patterns of expenditures. With conventional demand-side policies being constrained locally by governments' abilities to raise funds and by the growing levels of debt, addressing medium- to long-term growth requires creative supply-side reform. Improving the health of the financial sector and the business environment are essential in this regard, particularly the distortions currently in place that favour bank lending at the expense of capital market finance.

2. Banking sector

Despite the adverse macroeconomic conditions in the four partnership countries brought on by the global financial crisis and the political upheavals of the Arab Spring, the banking sector has not been destabilised. Confidence in the banking sector has remained strong, with no significant withdrawals except in Tunisia in early 2011. The depositor base has been stable, even increasing at times.

The sector operates according to a conservative business model based on domestic deposit funding and concentrates on basic lending activities with little reliance on external funding for local credit expansion. While this approach may not have realised the sector's full potential in developing the economies it serves, it did avoid the risks of causing further instability.

Some of the common themes observed in the four partnership countries in the banking sector include:

- Banking penetration in the four countries is limited, with the highest being in Morocco with 39 per cent of adults having a bank account. The lowest rate is in Egypt, at just 14 per cent.[5] The economies of the four countries are largely cash-based.

- Banks are generally profitable and well capitalised.[6] The sector in the four partnership countries is relatively large with total assets to GDP in 2012 ranging from 90 to 18 per cent. Other sector indicators, namely NPLs, provisions and capital adequacy, have held up well despite the economic slowdown.

- Except in Tunisia, sector concentration is high, with two to four banks accounting for most of the total assets, deposits and excess liquidity and, as a result, most of the market share of government funding.

- Liquidity conditions have tightened due to the difficult macroeconomic environment. The hands-on intervention by the authorities, in particular, liquidity injections by central banks, helped stabilise the situation. However, central bank liquidity injections, even though they have been regularly administered, will not translate into long-term lending.

[5] The figure for Egypt does not include the Postal Office, which also receives deposits.

[6] Tunisia is the exception, where recapitalisation of public banks will require public resources estimated at 1.7 per cent of GDP.

- Money markets remain underdeveloped. While Egypt exhibits a slight exception, interbank money markets are shallow and transactions are mostly concentrated in shorter maturities, with the majority being overnight.

  This situation prevails despite the shortage of liquidity within the banking sector. This is due to several factors: central bank operations tend to address each bank's liquidity issues; the interest rate environment is managed, with low volatility; and there are counterparty credit risks among banks. The increased use of secured money market transactions would help mitigate this.

  As a result, banks are dependent on central banks' management skills to address liquidity issues, rather than on the market to determine money market rates and interbank activity. More active interbank trading and liquidity risk management is needed to develop the interbank money market.

- Maturity and interest rate mismatches are large and would create significant risks in more volatile conditions. This could be addressed by increasing the issuance of certificates of deposit (CDs) and bank bonds. Banks' sensitivity to interest rate movements could be gradually reduced by issuing securities that better match the interest rate and maturity structures of their assets. However, limited investor demand and the low cost of deposit funding are hindering this. Ironically, the dominance of banks in financial intermediation is exacerbating the situation.

- Hedging instruments for both interest rate and exchange risk management are at an early stage of development but growing. Exchange rate risks are largely contained by the low volatility of the domestic currencies and the presence of various types of bank restrictions on FX transactions. There is little client demand for hedging instruments in general. Egypt is slightly more advanced in this regard than the other three countries with some derivatives limited to hedging activities in short one- to two-year tenors, mostly in the form of FX forwards and FX swaps. Derivatives are only allowed for commercial transactions and must be linked to two foreign currencies (derivatives involving the Egyptian pound are not allowed by the CBE). This will also impact foreign investor demand for local currency denominated assets, including government securities, as it is not possible for them to hedge exchange rate risks.

- There is a lack of a meaningful term structure of interest rates, which causes a lack of reliable pricing benchmarks. Coupled with the lack of long-term fixed-rate funding, this is limiting banks' ability to provide long-term domestic lending at fixed rates. Currently, banks transfer interest rate risks to borrowers by charging almost exclusively adjustable rates (Morocco is an exception), which can be changed at the banks' discretion.

- Large public sector financing needs are threatening to crowd out private sector lending. Banks are using large parts of their balance sheets to fund governments through the purchase of government securities. As a result, risks for the banking sector are closely related to governments and the latter's fiscal health. Banks may not be able to continue to rely on local authorities to provide liquidity should conditions tighten further.

- Encouraging governments to borrow internationally in a controlled and cautious manner improves domestic liquidity in the short term. In the medium to long term, fiscal consolidation and a more flexible exchange rate regime are needed to avoid liquidity drains.

- Bank lending is focused on large corporate borrowers, resulting in another form of concentration risk. SME lending remains relatively limited because of lending practices which rely mainly on collateral (excluding cash flow assessments) to determine borrowers' creditworthiness. Poor access to adequate, timely and reliable statistical data and information raises the cost of capital and hinders financing of SMEs.

- SMEs play a significant role in the four partnership countries in terms of their contributions to GDP and workforce absorption (80 per cent and 75 per cent, respectively, in Egypt's case). Banks have recently indicated a keenness to engage in risk-sharing arrangements in the SME segment with IFIs.

- Given the current state of the macroeconomic environment, some banks in the four partnership countries lack sufficient capital to support new lending while at the same time absorbing additional provisioning due to asset quality deterioration. The problem is compounded by ongoing pressure to maintain lending levels, often to distressed sectors of the economy.

- There is a need to set clearer rules on risk management and asset valuation, and to collect better prescribing data on all relevant financial sector risk elements (credit, liquidity, currency, operational), as this is key to the long-term stability of the banking sector. Ascertaining with accuracy, and in accordance with international standards, the levels of capital adequacy ratios and gaining a better perspective of the true nature of NPLs is essential to securing long-term lending growth.

3. Government debt market

A well-functioning government debt market is an essential feature in the development of local capital markets. A deep and liquid domestic government securities market provides a pricing benchmark for other financial instruments, including corporate bonds. It also enhances the scope of fiscal policy implementation under different fiscal cycles and aids in the effectiveness of monetary policy.

The effects of the global financial crisis coupled with the onset of the Arab Spring in 2011 have led to increases in the ratio of public debt to GDP in the four partnership countries to fund higher fiscal deficits and finance the amortisation of maturing debt. Hence, appropriate adjustment policies are needed to maintain public debt sustainability and contain vulnerabilities in the coming years as the share of domestic debt is expected to rise with the increasing funding requirements of governments.

Looking at the common themes in the four partnership countries results in the following observations:

- Total market size of government debt by outstanding amount is as follows (figures are from Bloomberg as of October 2015 and relate to central government debt): 190

issuances, US$ 155 billion in Egypt; 219 issuances, US$ 19 billion in Jordan; 93 issuances, US$ 52 billion in Morocco; and 38 issuances, US$ 10 billion in Tunisia.

- Government debt securities continue to dominate the local fixed-income market (Morocco is an exception to this where corporate bonds account for 50 per cent of the total market issuances by number of transactions but less than 20 per cent by volume). Two types of debt instruments are commonly used: T-bills and T-bonds. Issuance is mostly in local currency.

- The four partnership countries share similarities in terms of the evolution of their local public debt markets. Typically, a public debt law is in place that introduces various types of restrictions on the size and type of government borrowings. A government debt management department or unit is empowered to draw up a debt management strategy that emphasises meeting the financing needs of the government on time and at the lowest possible cost, with a prudent degree of risk.

- The market is underdeveloped with activity mostly confined to the primary market. The secondary market is small and illiquid. Primary dealer (PD) systems are in place (except in Jordan). PDs are typically banks, with limited competition from other capital market participants. Their obligations include a minimum volume of bids on the primary market, a minimum turnover on the secondary market, and the quotation of two-way prices for buying and selling government securities. There is a need to revise duties and privileges of PDs and put in place a set of incentives and penalties to create a more vibrant system able to feed liquidity on the secondary market.

- In some cases, PDs are unable to fulfil their obligations of quoting prices for securities that they do not hold in portfolio, and securities cannot trade intra-day as they cannot be sold before they are settled on T+1. Short selling is not practiced (with the exception of Morocco) and SLFs do not exist. As such, PDs cannot borrow securities to avoid delivery fails and this is not conducive to supporting their market-making activities. The PD system tends to emphasise an obligation to quote for specific securities rather than provide a constant quotation of some predefined benchmark maturity (reference rates), as in more developed markets.

- The development of the secondary market is further hindered by the lack of repo activity. In the absence of a liquid secondary market, the yield curve does not fulfil its function of providing a reference for the pricing of other financial assets. The absence of a sovereign yield curve is a significant impediment to the development of the capital markets in the four partnership countries. It is detrimental to the liquidity of the government securities market itself. The absence of a reliable pricing reference leads to a situation whereby assets held in fixed-income portfolios of institutional investors cannot be marked to market. This creates a perception of stability and an absence of market risks, which diminishes incentives for participants to trade. This, in turn, feeds into a lack of price transparency and a thin secondary market.

- The investor base is narrow. Banks tend to hold most of the government debt securities until maturity, perceiving them as risk-free instruments offering relatively high returns. A liquid secondary market would attract a wider variety of market participants, such as institutional (and retail) international investors, and allow for the issuance of longer-dated securities.

- To varying degrees, the authorities have gradually improved their approach to managing public debt but importantly they still do not fulfil their role in developing a reliable yield curve, which is a pre-requisite for the development of other fixed-income instruments. The role of managing the public debt is complicated by local factors. The stability, regularity and transparency of issuances and information dissemination need further attention. The process is negatively impacted by the insufficient reliability and predictability of the forecasted amounts of government receipts and expenditures. Any meaningful progress on resolving technical issues and addressing the bottlenecks needs coordination between the different stakeholders involved in the management of public debt and the issuance of government securities. More efforts need to be made on issuing benchmark maturities as a matter of policy within the framework of a regular and predicable issuance calendar. The approach of "if we don't need the cash today we will not issue" needs to be revised.

- There is a need to improve the quality of information disclosed to the market regarding issuance plans in terms of timing, types of instruments and final amounts, among others. A fixed pattern for an issuance calendar, including standardised redemption dates, should be adopted to avoid bunching maturities. Adding IR functionality along with a dedicated website to the DMU activities is also recommended.

- There are different stakeholders involved in the management of public debt and the issuance of government securities. These include the ministries of finance, central banks, PDs, capital market regulators, the stock exchanges and the CSDs as well as the DMUs. Any meaningful progress on resolving technical issues and addressing bottlenecks will require coordination between these various entities and their full commitment to a harmonised reform agenda.

4. Corporate bond market

A well-developed corporate bond market is vital for any economy as it (i) facilitates the efficient allocation of funds; (ii) eases infrastructure financing needs; (iii) develops the health of the corporate balance sheet; (iv) stimulates financial inclusion for SMEs and the retail investor; and (v) safeguards financial stability.

The corporate bond market in the four partnership countries is small and relatively inactive, with Morocco an exception to a certain extent due to market conditions in which corporate bond issues tend to provide issuers with better borrowing terms (loan demand exceeds deposit growth at commercial banks).

As such, common themes include:

- Major impediments to the development of the corporate bond market are the roles that banks play in the lives of corporates; the absence of a meaningful yield curve; the lack of a secondary market; and the perception of cumbersome issuance, registration, listing and disclosure requirements.

- The regulatory environment is not perceived as being user friendly but too extensive and prescriptive in nature. Several official bodies are typically involved in issuing bonds. Depending on the country, these include the comptroller of the companies (companies' law), the capital market authority (securities law), the exchange and local CSDs (listing and registration regulations), and the central banks (banking law) if the issuer is a commercial bank. There is a perception of overlap between the functions of these official bodies and a certain amount of confusion resulting from the interaction of several laws and legislative pieces governing the issuance, registration, listing and trading of corporate bonds.

- Additionally, the length of time it takes to apply for and receive approval of a bond issue is around three to four months, thereby exposing corporate issuers to potential disadvantages due to rapidly evolving market conditions. Shelf registrations and fixed-time regulatory responses are not common practices.

- Underwriters function on a best efforts basis, which has negative implications for the development of a secondary market. Book building is not common. The coupon is set early in the process for marketing purposes and little discussion happens later on to determine the yield. This problem is compounded by the lack of a transparent benchmark yield curve, which could provide guidance for estimating the likely funding costs to issuers.

- Deeper secondary market liquidity would expand the investor base and, by reducing the liquidity premium, help lower the overall funding costs, but this linkage is not recognised by stakeholders.

- Corporates, especially family-owned businesses, have close working relationships with their banks and prefer to access finance via bank channels. Family-owned businesses also tend to shy away from disclosure requirements associated with issuing bonds. There seems to be little differentiation in terms of regulatory vetting between public offers and private placements on the part of the regulators.

- Banks should be encouraged to issue various types of bonds (especially perpetual notes) to assist them in capitalisations and to maintain competitiveness. Otherwise, share capital will be the only source for Tier I capital, which puts banks in the partnership countries at a comparative disadvantage in relation to their regional peers. Banks also face maturity mismatches due to reliance on short-term deposits, an important factor in their hesitancy to extend fixed-rate loans. Facilitating various types of bond issuances for banks would go a long way in addressing this and encourage them to undertake longer-dated exposures.

- In general, issuers do not have the full range of bonds structures available to them. Hybrid instruments, such as convertible bonds, subordinated debt, perpetual bonds and bonds with equity-like characteristics are not utilised.

- The investor base is predominantly 'buy and hold' as the secondary market is almost non-existent and includes banks as well as (depending on the country) insurance companies, money market and mutual funds, and pension funds. There is limited interest from foreign investors given the lack of a secondary market as well as certain currency transfer restriction in some of the partnership countries. Retail investors are not presently participating in any meaningful manner in corporate bond market. Removing obstacles to collective investment schemes may be one way to encourage greater retail participation.

5. Islamic finance (sukuk)

The Middle East and North Africa (MENA) Islamic finance (sukuk) market has grown measurably in recent years, with most of this growth centred in the GCC countries. This growth enables both Islamic and conventional issuers from public and private sectors throughout the region to access previously untapped investor demand.

Nevertheless, the creation of a vibrant sukuk market will require a concerted effort over a number of years and expectations should be realistic, as it will take time to put the necessary legal framework in place and for the necessary investor base to develop further. Development efforts will require collaboration across governments, central banks, securities regulators, Sharia scholars and market participants.

The development of a sukuk market in the MENA region should not be considered separately, but rather within the context of the overall development of a regional Islamic finance sector. Developing and tailoring Islamic finance relevant, procedural and operational infrastructure frameworks are vital to support a sukuk market and address credit risk.

Although many of the measures proposed for the development of the conventional bond market equally support the development of a sukuk market, sukuk market institutional infrastructure is unique when compared to its conventional counterpart. Risk factors embedded in sukuk securities go beyond the conventional bond risk factors. These risk elements include market risk, which is related to liquidity and to profit/loss return mechanisms; risk aspects related to the underlying assets where the cash flow return is generated; legal and regulatory risks in terms of different structures' enforceability; and commercial and operational risks.

Common themes observed in the four partnership countries include:

- Sukuk issuance would allow governments in the four countries to broaden their funding sources. However, the introduction of new debt instruments such as sukuk will require a review of the government debt management strategy to ensure that proper controls, roles and responsibilities are in place. DMUs need to understand and be able to adequately measure risks associated with sukuk. Outstanding balances of sukuk, profit payments and redemptions should be included in calculations of sovereign indebtedness.

- The four countries are at an early stage of developing a sukuk market. Only Jordan has put in place the regulatory framework for the issuance and trading of sukuk, with no issuance yet.

- Islamic finance and sukuk markets are rapidly evolving globally and there is extensive debate on principles and practices among Sharia scholars and industry practitioners.

Initial focus in the four countries should be on establishing the basic and widely accepted elements necessary to support this development in their local currency capital markets. Provisions of the sukuk laws and regulations should be benchmarked against international best practice to make sure that international credit ratings are possible (when necessary) and that the products themselves and their parameters are in line with Islamic products elsewhere.

- At the local level, and as in Jordan's case, the other three partnership countries may wish to establish central Sharia councils to consider and eventually promulgate main fatwas governing Islamic finance. Doing so would streamline the process of establishing conventions and parameters for allowable sukuk structures.

- Governments in the four partnership countries could play an important role in the development of a sukuk market. A sovereign issuer can often provide the highest credit quality assets and attract the broadest range of investors in the local currency. Such sovereign sukuk transactions could also provide a useful template for potential non-government issuers.

- Segmenting a sovereign sukuk issue between the domestic and international markets might make it more readily accomplished. There have been successful sovereign sukuk in the international capital markets with a proven investor base. Foreign buyers of domestic sukuk can provide the market with more depth and eventually liquidity. In the domestic markets of the four partnership countries, it is not clear at this stage if sovereign sukuk issues would create incremental investor demand or crowd out other issues, including government conventional bonds and corporate bonds. Therefore, the broader impact of potential sovereign sukuk issuances should be carefully evaluated.

- Some countries have chosen to actively promote sukuk by providing certain advantages not accorded to conventional bonds. Exemption from certain transaction taxes or stamp duties may be needed insofar as they relate to transactions undertaken with assets under trust for purposes of a sukuk issue. This will remove distortions and create a level playing field.

- However, if the exemption from government fees extends beyond such asset transfer duties, for example exempting periodic profit payments from income tax, then sukuk would have advantages over conventional bonds. It would be useful to ensure that sukuk profits are treated the same as conventional interest under the tax code so that the development of a sukuk market is complimentary to the development of the other elements in the local currency market and does not drive other securities and instruments out.

- Fiscal advantages accorded to sukuk could provide a strong incentive for Sharia-compliant institutions, as well as conventional companies, to issue sukuk rather than conventional debt instruments. In such cases, sukuk could effectively displace conventional bonds instead of broadening the domestic capital market.

- Guiding principles that apply in the event of underperformance and/or default of sukuk should be clarified. Experience elsewhere in recent years has shown that legal uncertainty could arise when the performance of a sukuk falls below expectations or effectively defaults. With no applicable provisions and limited precedents, sukuk holders have been forced to seek solutions on the basis of case-by-case negotiations. Thus, it is suggested that the authorities in the four partnership countries evaluate the possible consequences of a default of a sukuk as they put in place the necessary legal and regulatory environment.

- Islamic financial institutions require Sharia-compliant instruments to manage their liquidity and central banks in the four partnership countries need to address this issue. Several countries in the region have created such instruments with differing degrees of acceptance.

- Originators of sukuk, including governments, typically transfer certain assets into Special Purpose Vehicles (SPVs). This aspect of sukuk has halted issuance plans by some governments. In addition to having appropriate legislation allowing for the creation of SPVs, the relevant laws and regulations must allow transfer or lease of state assets to an SPV.

- Sukuk investors should be assured of at least an equally rigorous regulatory framework as that for conventional bonds. The regulatory framework for sukuk should feature rigorous disclosure requirements and other elements to protect and inform investors.

- Global experience suggests that stimulating secondary market activity in sukuk is particularly challenging. This is due to a number of factors including the relative scarcity of Sharia-compliant assets, which contributes to 'buy and hold' behaviour. Another key factor is that sukuk are not issued in plain 'vanilla' forms as with conventional bonds. Each sukuk issuance has its own characteristics given the underlying asset. Therefore, most sukuk are illiquid. Due to the fact that some categories of sukuk are considered as evidencing indebtedness, they cannot be traded under Sharia. Market making, which drives conventional bond trading, is difficult due to a lack of means for dealers to finance their positions in a manner that is Sharia compliant. Efforts to develop such instruments are ongoing globally but general acceptance has not yet been achieved. Thus expectations for secondary market liquidity for sukuk in the four partnership countries should be modest.

- There are synergies between measures needed to support the creation of long-term investors for conventional bonds, such as pension reform, mutual funds and insurance regulations, and those needed to create a stable investor base for sukuk. Efforts to develop the sukuk market should go hand-in-hand with efforts to develop the overall domestic currency capital markets in the four partnership countries.

6. Equity markets

Equity markets in the four partnership countries are at varying degrees of development depending on which angle they are viewed from. As such, they exhibit both similarities and differences:

- In terms of size, although Egypt has the largest market capitalisation, it is Jordan's equity market that has the highest market capitalisation to GDP ratio at 75 per cent with 236 listed firms. Egypt's market capitalisation to GDP ratio stands at 24 per cent with 247 (up from 234 in 2012) listed firms, and Morocco has a market capitalisation to GDP ratio of 50 per cent with 74 listed firms while Tunisia's ratio is 21 per cent with 77 listings (up from 59 in 2012).

	2014			
Equity markets indicators	**Egypt**	**Jordan**	**Morocco**	**Tunisia**
Market cap as % of GDP for each exchange	24.32%	75.8%	50%	20.9%
Market cap in US$ billions	70.00	25.55	53.49	9.30
Traded volume in US$ billions	36.99	3.07	5.52	0.95
Equity turnover ratio	52.84%	12.02%	10.32%	10.22%
Number of listed companies	247	236	74	77

- Despite the relatively large number of listed companies, market capitalisation is concentrated in a few large companies, with a skewed sector representation. A monopoly is exercised with a small number of listed companies accounting for a disproportionate share of the market capitalisation as well as trading volumes and values (concentration of liquidity). Certain sectors predominate, such as construction, banking and financial services, and telecommunications. Additionally, large portions of listed shares are owned by individuals associated with the listed firms as well as foreign strategic investors who do not typically engage in trading activities. The turnover ratio for Egypt is 52.84 per cent, Jordan 12.02 per cent, Morocco 10.32 per cent and Tunisia 10.22 per cent.

- The impact of the global financial crisis on stock market performance in the four partnership countries has been negative. Markets were fairly liquid and deep during years leading up to 2008 and have not managed since to match pre-2008 levels in terms of liquidity and market capitalisation. Political developments since the onset of the Arab Spring in 2011 have not helped.

- As a result, primary market activity remains shallow with few IPOs since 2008 and after 2011 reflecting political uncertainties and the volatile cost of equity. The limited supply of new listings reflects low valuation levels as well as long-standing structural issues that include companies' reluctance to abide by disclosure requirements and a lack of a stock market culture and understanding of listing benefits. Competition from the banking sector, which often offers attractive rates, makes funding through the stock market unappealing. For the entire period 1995-2012 Jordan had 47 IPOs, while in Egypt there were 41, Morocco 36 and in Tunisia 21. Egypt and Morocco have both experienced a slight acceleration in IPO activity since 2012.

- Equity finance is often viewed by owners of companies as an exit tool to cash out their business when valuations are favourable, a tool for estate planning by providing shares to heirs and relatives, or as a loyalty programme to reward their employees; but not as a tool to raise risk capital. There is little appreciation of the role that equity plays in the financial structures of companies. Consequently, equity financing is generally viewed by potential issuers as a cumbersome, expensive and unattractive funding alternative to bank loans.

- Private equity funds, although present in the four partnership countries, are not sizable enough to have a meaningful impact on the development of an IPO pipeline. Privatisations are generally on hold due to political considerations after the onset of the Arab Spring.

- Foreign investment is needed to supplement domestic sources. Participation of foreign investors helps increase liquidity and investor diversity. Foreign investors exited stock markets in the four partnership countries since the global financial crisis and have only returned opportunistically, reflecting macroeconomic imbalances as well as factors related to the characteristics of listed companies and market regulation.

- Insufficient free floats, small market capitalisations, and lax disclosure and corporate governance requirements have all contributed to this. Companies have a limited capacity to offer proper IR services including the publishing of financials in English and in a format that reflects common international practices. In some cases, repatriation delays of profits and dividends were of concern. Valuations in terms of projected price/earnings ratios may be considered relatively high compared to regional markets or to other emerging and frontier markets. The lack of a meaningful IPOs pipeline, in numbers and size, has also dampened international investor interest.

- Current foreign investor holdings tend to be of a long-term strategic nature with a large portion held by Arab investors. Consequently, foreign investors' role in secondary market activity is rather limited. The sectoral mismatch between the underlying economies of the four partnership countries and listed firms limits international investor appetite to a certain extent as emerging market portfolios seek a broad exposure to a country's economy.

- Demand for equity in Jordan and Tunisia comes mainly from local retail investors and institutional investor participation in the stock market is rather limited, reflecting a fund management industry that is still relatively small and in need of further reform and development. Egypt and Morocco differ. In Egypt there is a balanced mix of retail and institutional investors reflecting a more developed institutional investor culture. In Morocco, institutional investors are the dominant investors in the equity market.

- The collapse of share prices since the global financial crisis and the onset of the Arab Spring severely affected investors' views and confidence in the stock markets in the four partnership countries. In some cases, questions were raised about the enforcement capabilities of regulatory bodies as some of the newly listed companies did not have viable businesses and, in others, parties related to the listed companies profited from the IPOs at the expense of other shareholders.

- The prolonged period of low trading volumes since the global financial crisis has affected the financial viability of brokerage firms. Some have considerable volumes of NPLs on their books as leveraging client purchases of shares with loans from brokerage firms above and beyond margin is a common practice in some of these markets.

- Brokerage firms focus on order routing and trade execution but typically do not provide relevant information to support their clients' investment decisions. Higher value-added services remain underdeveloped. Continuous research coverage of listed companies is in short supply. New issue managers prepare prospectus upon an IPO but there is little continuous monitoring of the company's business and financial development. There are also few research materials to inform investors about a company's performance once the shares have been placed in the primary market. As a result, investment decisions and market turnovers by local retail investors are mostly based on market sentiment and informal information, significantly affecting stock market prices on relatively thin trading volumes.

- Liquidity could be enhanced and a faster and more efficient price discovery mechanism realised with the diversification of financing instruments and practices to include short selling, securities borrowing and lending, ETFs, REITs and sukuk.

- The demutualisation and/or corporatisation of stock markets to expand ownership structures and improve incentives to increase overall revenue streams is under consideration.

- There is a need to facilitate access to finance for SMEs in the four partnership countries due to the important role they play in terms of their contributions to GDP as well as employment generation. With the exception of Egypt launching the Nilex market, SME funding via the stock market is a neglected topic. There is room for a coordinated regional approach between the stock markets of the four countries to address this need.

7. Investor base

The dominant role of banks in the government debt market has been highlighted elsewhere in this report. This section focuses on the other components of the institutional investor base such as collective investment schemes, pensions and insurance companies. Each of these components has experienced varied degrees of development in each of the four partnership countries. Consequently, the composition of the local investor base does not exhibit many common characteristics.

Egypt

- The state retains a strong role in both the pension and the insurance sector. Insurance and pension funds remain underdeveloped. Participation in the government securities' market is small and is primarily conducted via banks. Typically, demand is for short-term securities. The major life insurer is state-owned and has a market share of around 50 per cent.
- While some of the larger companies offer private insurance to their workers, insurance penetration as a percentage of the population remains very low.
- Auto insurance is compulsory and provided by private insurers.
- There are currently 610 private pension funds registered with the Egyptian Financial Services Authority (EFSA), with E£ 40 billion in assets under management (AUMs).
- Regulatory guidance and oversight is thin but will improve with the introduction of a new insurance law and a new executive regulation for the Private Pension Funds Law.
- Professional management of assets is lacking. The wider workforce would be well served if professional management of private pensions were generally available within a well-regulated framework. Reform efforts should focus on tax deductibility of contributions, protection of gains and income, and portability across employers.

- Around 80 per cent of private insurance companies' AUMs are invested in government instruments.
- Commercial banks sponsor most of the 88 professionally managed funds. The majority of AUMs are in money market funds, which are not allowed to invest in assets with maturities beyond 13 months or below investment grade. They are also limited in terms of exposure to single issues to about 10 per cent of their net assets.
- The Post Office Investment Fund is the other major force in investing. It has developed its own asset allocation strategy and has diversified into government bonds and bills, equities, corporate bonds and some private equity, both on its own and through managers.

Jordan

- The concept of professional asset management is not well developed and is hampering the emergence of longer-term investment horizons. The population has not been introduced to financial planning in a sufficient manner.
- Mutual funds have a very limited presence due to the lack of an incentive structure as well as existing legal and regulatory hurdles.
- The principal pension system is a state-operated pay-as-you-go defined benefit scheme. Although it manages substantial assets (around Din 5 billion), its contribution to the domestic capital market development is limited, especially as it crowds out the growth of private pensions.
- There is also an absence of fiscal incentives to support the development of private pension funds, which limits the development of a diversified institutional investor base.
- Insurance penetration rates are low, the bulk of policies are non-life, and investment policies are short term and lack a professional focus.
- Retail savings are either in bank deposits, real estate, the stock market or simply kept in cash.

Morocco

- Insurance companies are significant investors in the capital market. The insurance sector is sizable and made up of 18 companies with international insurers also active. Penetration as a percentage of GDP stood at 3.1 per cent as of December 2014 and insurance sector assets stood at approximately 19 per cent of GDP. Life insurance investment products cover 3.8 million Moroccans.
- The mutual fund industry is the other key investor base. There are 18 asset management companies with 360 mutual funds operating with the equivalent of US$ 14.8 billion of AUMs. The investor base for mutual funds is primarily made up of institutional managers based in the asset management arms of commercial banks, investment houses and insurance companies as well as corporate clients and high net worth individuals.
- The pension system is operated primarily by three public organisations and one private. The pension sector is a significant investor especially in government debt with over 60 per cent of portfolios invested in fixed-income securities, and the balance is mostly in equities and, to a lesser extent, mutual funds. The pension system is confronted with a structural problem as Morocco faces a rapid demographic shift due to an ageing population. Reforms are needed to ensure the financial stability of the pension system in the long run.
- The Caisse de Depot et Gestion (CDG) is the largest non-bank financial institution holding the equivalent of US$ 9.3 billion of AUMs and manages savings funds mainly

composed of social security funds and deposits from the postal bank. It manages two public retirement and provident funds. Its activities include banking, insurance, property development, tourism and infrastructure.

- A number of savings schemes that benefit from preferential tax treatment have been introduced but with limited and varied success.
- A key issue for the further development of the investor base is the absence of a reliable reference yield curve, which prevents accurate market pricing of securities and assets are valued at historical cost rather than mark-to-market.

Tunisia

- The mutual fund industry is well developed but insurance companies and pension funds play a limited role.
- There were 106 Organisme de Placement Collectif en Valeurs Mobilières (OPCVMs) operating at the end of 2011 with total AUMs of Din 5.2 billion, or 8 per cent of GDP. Two-thirds of mutual fund investors are retail investors, who are attracted by the higher returns without many perceived risks. This is due to the absence of market pricing whereby bonds, which represent 65 per cent of total AUMs, are valued at historical cost rather than mark-to-market due to the absence of appropriate pricing in the primary sovereign bond market and the illiquidity of secondary markets (no yield curve). If interest rates increase, mutual funds will accumulate unrealised losses and large withdrawals would force the funds to realise losses, further exacerbating the situation.
- Insurance companies, with a focus on casualty (as opposed to life insurance), invest in short-term securities.
- There is a need to restructure the pension system. The two pension schemes have annual operating deficits and it is more likely that government support of the pay-as-you-go system will produce more volume on the supply side than the demand side.

8. Market infrastructure

Some of the common themes observed in the four partnership countries include:

- The basic legal framework for clearing and settlement is set out in several laws, legislative and regulatory pieces of varying hierarchies that include central banks, ministries of finance, capital market regulators, the exchanges and the CSDs. As a result, some of the organisations involved in securities clearing and settlement are regulated and supervised by different authorities and special care should be given to avoid overlapping or contradicting regulatory requirements and to streamline oversight and banking supervision processes.

- All securities are immobilised or dematerialised and are transferred in book-entry form. The local CSDs hold ownership records for all securities issued by the private sector while there are cases where government and central bank securities are registered in the book-entry systems of the central banks. Depending on the country, equities are cleared and settled either on T+2 or T+3 on the basis of delivery versus payment (DVP) following BIS models 1 or 2.

- The capital market regulators have supervisory and regulatory authority over key capital market institutions with the goals of protecting investors and promoting sound financial markets. As such, their responsibilities do not include the payment systems part of the securities clearing and settlement process. Typically, net cash positions are settled through a real time gross settlement (RTGS) system, which is operated by the central bank. Overall, the RTGS systems in use work smoothly and are meeting the business needs of participants. Hence, there is a need for the CSDs to be subject to more transparent and effective supervision, regulation and oversight by both capital market regulators and the central banks.

- With the exception of Tunisia, where securities transactions are not settled on a full DVP basis, and Egypt, where settlement performed by the central bank for T-bills and CBE notes is not currently based on DVP, the legal and regulatory environment for primary and secondary market in the four partnership countries seems to be generally sound and the infrastructure largely adequate for today's market needs.

- Certainty that asset segregation functions properly is important for investors. Legal and regulatory improvements are required to eliminate custody risk. Custody arrangements for securities at the CSD and the custodian levels should be assessed to make sure investors are duly protected from any potential claims from creditors in the event a custodian goes bankrupt. Additionally, authorities should ensure that all customer assets are duly segregated from the custodian's own holdings and appropriately accounted for in the respective sub-accounts.

- Where more than one depository and settlement system exist (for example, Egypt and Jordan), the authorities should assess the option of moving to a CSD and build links to international central securities depositories (ICSDs) and clearing houses.

- The opportunity to transform the current guarantee funds into a CCP should be thoroughly examined. The use of a CCP that interposes itself between the counterparties to securities trades is increasingly becoming common practice in other markets. It is an especially effective tool for reducing risks in relation to active market participants.

9. Corporate governance

The past decade has seen an evolution of corporate governance awareness and practices in the MENA region. This evolution was driven by a number of factors, notably international convergence on certain good governance rules, the interest of international portfolios in the region, the necessity to deal with the impact of the global financial crisis on the region and to regain investor confidence, and the need to address concerns heightened by the onset of the Arab Spring regarding public sector and public shareholding company accountability.

The Organisation for Economic Co-operation and Development (OECD) started its work on promoting corporate governance in the MENA region in 2006. At that time, the focus was to support the development of sound governance frameworks and practices in the banking sector and in state-owned enterprises (SOEs). Banks were, and remain, the primary source of corporate finance in the region and account for about half of the capitalisation of stock exchanges in the region, in part due to their high contribution to the GDP, and in part due to mandatory listings of banks in some jurisdictions. SOEs are estimated to account for approximately a third of national GDP, depending on the country.

These efforts culminated in a Policy Brief on Improving Corporate Governance of Banks in the MENA region, released in November 2009. The Policy Brief incorporated over 70 recommendations, primarily addressed to management and boards of banks, their supervisory entities, notably central banks and, in the case of listed banks, the securities regulators and stock exchanges. The Policy Brief incorporated some of the region's existing good practices, the OECD findings and conclusions from the analysis of the financial crisis, and recommendations contained in the OECD Principles for Corporate Governance and the OECD Guidelines on Corporate Governance of State-Owned Enterprises.

The following common themes can be observed when viewing the corporate governance landscape in the four partnership countries:

- The ongoing development of capital markets in the four countries and attempts to promote listed companies with international investors created a need for greater transparency, adherence to corporate governance best practices as well as effective IR functions.

- The onset of the Arab Spring heightened awareness of the need to reform the corporate governance modus operandi in public shareholding companies. A growing number of complaints to the securities regulators for investigations were observed, especially in Tunisia, Egypt and Jordan, where there were allegations of crony capitalism in a number of companies that were listed or had linkages to listed companies. Issues pertaining to related party transactions, responsibilities and capabilities of external auditors, nepotism in appointments of senior management, lack of independence of board members and of members of the audit and nomination and remuneration board committees were prominently featured in complaints.

- Listed companies are subject to several authorities' regulatory powers that include the ministries of industries and commerce which are responsible for the application of the companies' laws, capital market regulators who are responsible for the application of the securities laws, as well as, in the case of banks, central banks who are responsible for the application of the banking laws. As a result, there are inconsistencies and contradictions in the different legislations when it comes to corporate governance requirements and delineation of enforcement powers is not clear.

- The regulation and oversight of listed companies is predominantly the responsibility of the securities regulators who have extensive regulatory responsibilities and powers under their respective securities laws. However, the application and enforceability of corporate governance codes varies in the four partnership countries. In Jordan, the code is applied on a 'comply-or-explain' basis while in Egypt, Tunisia and Morocco the codes remain voluntary.

- Listing requirements of exchanges do contain corporate governance requirements. However, in some cases (Jordan, for example) it is not clear whether enforcement, once 'comply or explain' has been phased out and replaced with mandatory requirements, will rest with the exchanges themselves or with the capital market regulator. A prevailing view in the four partnership countries is that the powers of stock exchanges relative to corporate governance oversight and enforcement are much more limited than those of the securities regulators, and that the listing agreement may not have sufficient legal traction in this regard.

- While the level of awareness among board members and executives of good governance practices has evolved, the implementation of governance codes is often perceived by the corporates from a purely compliance-oriented perspective. Investor engagement will be important to demonstrate that market participants have certain expectations of their investee companies in terms of their governance arrangements, with risk premiums placed in cases of deficiencies.

V. Country-specific recommendations

1. Egypt

Macroeconomic environment	
Allow more flexibility in the foreign exchange (FX) regime.	Short-term
Set-up framework for infrastructure funding through capital markets.	Medium-term
Reduce public debt.	Medium-term
Reduce fiscal deficit.	Medium-term
Banking sector	
Provide incentives for banks to provide more liquidity in the secondary treasuries market.	Short-term
Enhance sector efficiency and promote competition.	Medium-term
Develop an active interbank money market and pricing benchmarks.	Medium-term
Improve small and medium-sized enterprise (SME) and micro enterprise access to finance.	Medium-term
Implement measures to increase financial inclusion.	Medium-term
Ensure Non-performing loan (NPL) resolution and possible utilisation of securitisation.	Medium-term
Enhance bank asset-liability management (ALM) practices to align with Basel II implementation.	Medium-term
Government bond market	
Appoint a joint committee to harmonise stakeholders' interests (Ministry of Finance, Central Bank of Egypt, Egyptian Financial Services Authority [EFSA], Misr for Central Clearing, Depository and Registry [MCDR]) and produce a coordinated debt capital market development plan.	Short-term
Increase Debt Management Unit (DMU) resources in terms of staffing and capacity-building.	Short-term
Raise the amount and maturity of outstanding benchmark securities.	Short-term
Put an electronic trading platform in place.	Short-term
Negotiate conventions with some primary dealers (PDs) to quote reference rates.	Short-term
Provide universal access and eliminate the 'de facto PDs' trading monopoly in the secondary market of T-bonds.	Short-term
Revise PDs' code of duties, and grant PD status to some quasi-investment banks.	Short-term
Harmonise withholding tax on treasuries to remove distortions.	Medium-term
Develop repo market.	Short-Term
Corporate bond market	
Commit to providing rapid responses to applications to issue bonds.	Short-term
Widen the range of bond structures that can be	Short-term

issued.	
Achieve consistency in taxation of interest and collection methodology between government and corporate bonds.	Short-term
Create tailored rules for issuance, marketing and listing of bonds and sukuk.	Medium-term
Add flexibility to the requirement that all bond issues be rated.	Medium-term
Encourage development of bond industry organisation.	Medium-term
Review projects in the public–private partnership (PPP) pipeline for suitability for capital market financing.	Medium-term
Sukuk	
Include global Islamic finance professionals in the technical planning for sukuk.	Short-term
Ensure maximum possible consistency in approvals and disclosure for sukuk and bonds.	Short-term
Review all options available globally for short-term sukuk.	Short-term
Achieve tax neutrality of bonds and sukuk; exempt assets under trust from transfer taxes.	Short-term
Integrate sukuk into the sovereign risk management framework.	Medium-term
Develop a multi-year action plan for development of the Islamic finance sector.	Medium-term
Equity markets	
Maintain awareness campaigns with a particular focus on well-recognised and geographically diversified private sector entities that could be potential large flagship issuers.	Short-term
Mobilise financial resources to support medium-sized companies to list on Nilex.	Short-term
Strengthen links with private equity players for exit strategy.	Short-term
Increase minimum required free float.	Short-term
Enhance investor relations (IR) capacity of listed firms.	Short-term
Consider introducing new collective instruments that monetise sectors such as Real Estate Investment Trust (REITs), SME funds and infrastructure funds.	Medium-term
Reform governance practices at private pension funds and insurance companies to create a sizeable institutional investor base.	Medium-term
Investor base	
Reform management of private pensions and enhance their governance.	Medium-term
Adopt global standard regulation for the insurance industry.	Medium-term

Address concerns of foreign investors over settlement, clearing and cost of transacting.	Medium-term
Encourage the growth of bond funds and address limitations.	Medium-term
Dialogue with global professional Sharia-compliant investor base.	Medium-term

2. Jordan

Inter-agency coordination	
Establish a task force of high-level officials from the Central Bank of Jordan (CBJ), Ministry of Finance, Jordan Securities Commission (JSC) and private sector to formulate an action plan for developing the local bond and sukuk market.	Short-term (commenced)
Government debt markets – Primary market	
Publish an auction calendar with firm amount for Treasury bonds.	Medium-term
Allow bidders to submit more than one bid.	Short-term
Provide predictability by (i) announcing maturities 3-5 days ahead of auction, (ii) announcing target amount 2 days ahead of auction, (iii) announcing target as a range, (iv) consistently accepting bids up to at least the minimum of the target range, and (v) cancelling auctions only in the most extreme situation.	Short-term
Adapt a more flexible approach to issuance of Treasury bills to support greater predictability in the Treasury bond markets.	Medium-term
Develop the Public Debt Department's (PDD) capacity and systems to facilitate the issuance of benchmark securities at a later stage.	Medium-term
Improve the cash flow projection capacity at the level of the Ministry of Finance.	Medium-term
Government debt markets – Secondary market	
Streamline access to the primary and secondary markets for non-resident investors.	Medium-term
Collect and consolidate indicative quotes from market participants.	Short-term
Consider offering a portion of government bond issuance directly to retail investors.	Medium-term
Give careful consideration to the interaction in the money market between certificates of deposit (CDs) issued by the CBJ and Treasury bills issued by the PDD.	Medium-term
The CBJ should collect indicative quotes from market participants and consolidate them to provide market price indications for the principal government bonds.	Short-term
Evaluate the benefits and implications of introducing new instruments; promoting participation in existing instruments is likely to reduce fragmentation and	Medium-term

contribute to the overall development of the government securities markets.	
Corporate bonds – Supply side	
Streamline the approval process for issuance and listing of corporate bonds.	Short-term
Improve corporate governance standards and investor relations.	Short-term
Raise awareness of bond finance among potential issuers.	Medium-term
Develop regulation to enable issuance of basic hybrid bonds such as convertible bonds.	Medium-term
Establish separate continuing disclosure requirements appropriate for issuers of corporate bonds.	Medium-term
Corporate bonds – Demand side	
Develop a market consultation mechanism for regulators.	Short-term
Address concerns raised by international investors and market evaluators.	Medium-term
Islamic finance	
Formulate national Islamic finance strategy to support demand and creation of instruments complementary to sukuk, such as money market instruments and *takaful*.	Short-term
Achieve 'tax neutrality' for Islamic finance, thereby putting sukuk and conventional bonds on a level playing field.	Short-term
Revise regulations regarding the use of Special Purpose Vehicles (SPVs), in particular the requirement for equity.	Short-term
Adopt sukuk as a government funding instrument.	Short-term
Examine and adjust the debt management framework to ensure proper controls are in place as a perquisite for issuance of sukuk.	Short-term
Equity market	
Enforce corporate governance standards for listed companies and determine which agency will be responsible for the task.	Short-term
Enforce regulations to ensure stockbrokers reduce credit and settlement risks.	Short-term
Strengthen professional qualification standards for brokers and new issue managers.	Medium-term
Review eligibility criteria and due diligence standards for listing.	Medium-term
Allow speedy delisting of non-viable companies.	Short-term
Regulatory and legal framework	
Require intermediaries to report any material breach of the JSC's instruction immediately, in particular for brokerage firms' loans to their clients.	Short term
Prepare implementing regulations for sukuk law.	Short term
Enhance cooperation and coordination between various regulatory authorities, possibly by creating a	Short term

financial stability committee.	
Approve and implement the current amendments to the Securities Law prepared by the JSC aimed at enhancing its independence; such changes should also cover the JSC salary structure to attract and retain suitable staff. Provide for creation of an enforcement department within the JSC.	Short term
Clarify treatment of derivatives to confirm that derivative transactions are not gambling or speculative transactions. Provide a framework for set off and close-out netting.	Medium-term
Consider development of a legal and regulatory framework for broader range of capital market instruments.	Long- term
Financial market infrastructure	
Establish oversight authority of the CBJ and extend it to securities settlement systems and all relevant retail payment systems.	Medium-term
Ensure that the JSC and the CBJ have the ability and sufficient resources to carry out their regulatory and oversight responsibilities.	Ongoing
The CBJ should establish appropriate organisational arrangements for oversight of payment systems.	Short-term
Upgrade the CBJ's Central Securities Depository (CSD), in order to achieve true DVP for repo transactions.	Medium-term
Assess the pros and cons of unifying CSDs.	Medium-term
Strengthen corporate governance arrangements of the Securities Depository Centre.	Medium-term
Investor base	
Examine and amend the regulatory frameworks for pensions and insurance to include prudential investment guidelines that ensure actuarial integrity, safety and liquidity of investments.	Medium-term
Enhance the environment for foreign investors by addressing governance issues and inadequacies in market infrastructure.	Medium-term
Promote a culture of saving; consider according tax advantages to certain retirement and educational savings.	Medium-term

3. Morocco

Macroeconomic environment	
Shift public debt issuance more to external markets to reduce pressure on the domestic markets and prevent crowding out of private investment.	Short-term
Banking sector	
Prepare a strategy for gradual further liberalisation of the interest-rate-setting mechanism in the interbank money market.	Medium-term

Allow a higher degree of fluctuation of interbank deposit rates to restore the market's price signalling function.	Short-term
Introduce financial tools to help banks reduce maturity and interest rate mismatches on their balance sheets.	Medium-term
Government bond market	
Develop a more formal debt management strategy, which articulates operational goals and the implementation roadmap.	Medium-term
Continue to improve benchmark issuance by increasing maximum size and streamlining auction frequency.	Short-term
Revise Intermédiaires en Valeurs du Trésor (IVT, primary dealers) agreement and provide a securities lending facility (SLF) to support market-making activity.	Short-term
Facilitate clearing of government securities at international central securities depositories (ICSDs).	Medium-term
Identify steps to be taken to diversify the investor base, including by attracting foreign investors.	Medium-term
Corporate bond market	
Ensure effective and speedy resolution of bankruptcy when needed.	Short-term
Enhance credit analysts' capacities and professional standards.	Medium-term
Consider using Conseil Déontologique des Valeurs Mobilières (CDVM) to guide the introduction process of external credit ratings to the Moroccan bond market, in addition to the recent partial waiver of listing fees for rated issues.	Short-term
Explore policy measures to encourage local banks to provide secondary market liquidity for their own bonds.	Medium-term
Revise valuation rules for institutional investors of corporate bonds to reflect credit spread changes in valuation.	Medium-term
Provide incentives for institutional investors to invest in bonds (risk weight, tax).	Short-term
Equity markets	
Address structural issues to encourage long-term supply of paper, focusing on large flagship issuances and a continuous flow of new paper from average-sized issues.	Medium-term
Encourage large family-owned businesses and medium-sized companies to list and ensure market access.	Medium-term
Increase the free float of listed state-owned enterprises (SOEs) and the minimum required free float in general.	Short-term

Conduct thorough analysis of the proposed changes to the ownership structure of the stock exchange, to ensure that conflicts of interest are minimised.	Short-term
Assess how to implement securities lending, short selling and derivatives to increase liquidity while minimising volatility.	Medium-term
Include SOE governance needs in pending SOE review, to improve readiness for issuance.	Medium-term
Introduce new collective investment instruments that monetise sectors, especially infrastructure funds, REITs, and other Exchange Traded Funds (ETFs) and/or SME funds.	Medium-term
Encourage development of intermediary capabilities, research culture and best practice.	Medium-term
Identify steps to be taken to diversify the investor base by attracting foreign investors.	Medium-term
Sukuk	
Institute long-term strategy and develop the legal and regulatory standards.	Medium-term
Explore the scope for establishing sukuk within the standard financing tools for public debt management.	Short-term
Amend tax rules to ensure neutrality for various sukuk structures.	Medium-term
Use recent passage of securitisation law to introduce environmental, social and governance issues which also would be Islamic compliant (e.g., for infrastructure projects).	Medium-term

4. Tunisia

Banking sector and money markets	
Introduce consolidated supervision and undertake measures to improve the health of the financial sector as per Financial Sector Assessment Program (FSAP) recommendations.	Short-term
Allow for more flexibility in deposit rate determination and loosen the cap on lending rates.	Short-term
Create a money market hedging instrument based on overnight deposits.	Medium-term
Set clear risk management and asset valuation rules, and prescribe data collection on all relevant risks (credit, liquidity, market, currency, operational).	Medium-term
Establish capacities for risk-based micro-prudential regulation and macro-prudential regulation.	Medium-term
Reconsider the role of public banks in economic	Medium-term

development. Allow independent business decisions for the management team based on sound banking principles.	
Government debt markets	
Reduce emphasis on long maturities (e.g., 3-5-7 instead of 3-5-10).	Short-term
Enhance regularity in the issuance programme.	Short-term
Adopt active management of the government cash position.	Short-term
Develop the repo market.	Short-term
Improve the Spécialistes en Valeurs du Trésor (SVT) system and the role of SVTs in pre-trade and post-trade price dissemination.	Short-term
Introduce a transaction reporting system.	Short-term
Implement mark-to-market practices for fixed-income portfolios.	Short-term
Establish incentives for trading with institutions outside the same financial group.	Short-term
Increase current ceiling of Din 400-600 million for long benchmark maturities.	Medium-term
Limit to 50 per cent (or less) the share of allocated securities to a single bidder at the auction.	Medium-term
Introduce liability management operations.	Medium-term
Implement stricter quoting obligations by SVTs.	Medium-term
Introduce a securities lending facility (SLF) to support market making by SVTs.	Medium-term
Introduce an electronic trading platform.	Medium-term
Encourage foreign investors' participation by improving transparency and infrastructure of the government debt market.	Medium-term
Encourage the use of insurance products, especially life insurance, to develop natural demand for longer-dated securities (education, distribution).	Medium-term
Restructure the current pension schemes and develop private pension systems.	Medium-term
Corporate bond markets	
Ensure appropriate tax treatment for corporate bonds.	Medium-term
Limit intra-group dealings to create greater transparency and independence of the mutual fund manager.	Medium-term
Require reporting standards for commercial paper (CP) and CD issuance, especially if issues can be as long as bond issues.	Medium-term
Streamline the issuance preparation process.	Medium-term
Introduce and enforce tailored regulations for sukuk.	Medium-term
Encourage market pricing in mutual funds to ensure that fund investors find the investment to be credible.	Medium-term

Restructure the pension industry and promote penetration of life insurance to broaden the investor base.	Medium-term
Review requirements and standards for information to be included in the prospectus and simplify them as appropriate.	Medium-term
Equity markets	
Encourage initial public offerings (IPOs) from suitable confiscated assets and SOEs.	Short-term
Reduce administrative and regulatory burdens for public issuance.	Short-term
Ensure information disclosure is appropriate and helps investors make investment decisions.	Short-term
Financial market infrastructure	
Implement a full DVP-based securities settlement process.	Short-term
Improve governance of Société Tunisienne Interprofessionnelle de Compensation et de Dépôt des Valeurs Mobilières (STICODEVAM) by revamping its board.	Short-term
Review the technical platform and system of STICODEVAM and enhance the Business Continuity Plan related to the overall securities settlement process.	Short-term
Strengthen cooperation among all the stakeholders (Banque Centrale de Tunisie, Conseil du Marché Financier, Bourse des Valeurs Mobilières de Tunis [BVMT] and STICODEVAM) in the securities market.	Short-term
Undertake a review of the legal framework related to STICODEVAM activities.	Medium-term
Set up Central Counterparty (CCP) arrangements at the BVMT.	Medium-term

Annex 1: Key recommendations and themes from the Arab Debt Market Development Initiative (ADMDI) missions

Since the joint project of the Arab Monetary Fund (AMF) and the International Monetary Fund (IMF) was launched in 2009, four countries (Bahrain, Oman, Jordan and Kuwait) have participated in the ADMDI assessment exercise. Some of the emerging common themes are: abundance of liquidity in the banking sector; lack of a clear strategy for government funding; irregular issuance across the yield curve; and weak coordination between the ministries of finance and central banks.

Nonetheless, there are some emerging differences, including, the size (and level) of development of government securities markets, degree of investor base diversification and sophistication, and scope to issue Islamic-compliant products.

Priorities and challenges for Jordan and Tunisia covered by the ADMDI project reflect their specific circumstance, leading to the following recommendations:

Jordan (First Mission)

- Develop an explicit debt management strategy and enhance transparency in the primary market.
- Enable the use of T-bills for monetary policy purposes.
- Establish a formal reference pricing (end-of-day) mechanism.
- Develop a more diverse investor base by encouraging the development of institutional investors.

Tunisia

- Undertake measures to improve the health of the financial sector per Financial Sector Assessment Program (FSAP) recommendations.
- Encourage the development of a sovereign yield curve to eliminate the risk of having mispriced fixed-income securities.
- Encourage foreign investors' participation by improving transparency and infrastructure of the government debt market.
- Encourage the use of insurance products, especially life insurance, to develop natural demand for longer-dated securities.
- Restructure the current pension schemes and develop private pension systems.
- Streamline the issuance preparation process for corporate bonds to allow more market sensitivity and normalise taxation so that it does not favour equities.

Annex 2: Roles and responsibilities of a debt management unit (DMU)

The typical functions of an operational DMU would generally include the following front, middle and back office roles. It should be noted that this coverage may not be entirely comprehensive and would need to be adapted to the specific cicumstances of a particular country. In addition, where responsibilities are fragmented, this list should be augmented to identify which entity is responsible for which activity.

1. Front office

Function	Sub-function	Comment
Market analysis	Market monitoring	• Assessment and analysis of conditions in fixed-income markets (including money, repo, futures and swaps)
Pre-transaction analysis	Choice of security (i.e., maturity, type, coupon, etc.)	• Assessment of market environment, generation of proposals, market intelligence, valuation and yield curve analysis • Consistency with strategy • Domestic and external; loans and securities • Both for debt and cash management transactions
	Debt swaps and other portfolio restructuring operations	• Assessment and generation of proposals • Consistency with strategy
	Project finance	• Assessment and generation of proposals, market intelligence and valuation • Consistency with strategy • Project viability • Links with loan negotiation (see next page)
	Transaction preparation	• Choice of lead manager (external) • Structure of sale (external) • Preparation of issuance notices and auction announcements • Road shows
Transaction execution	Management of domestic auctions	• May use the central bank as agent, but decisions lie with DMU • Decision on timing of operation • Receipt of bids • Review of bids • Reserve pricing decisions • Allocation decisions • Announcements
	Management of external issuance	• Relationship with lead manager • Allocation decisions
	Debt swaps and other portfolio restructuring operations	• Pricing
	Sale post-mortems	• Domestic and external issues

	Cash management operations, including issuance of short-term bills or short-term placements	• Use of an execution agent might be appropriate
Management of loan and credit portfolio (if relevant)	Negotiation of new loan terms. Legal advice	• Project viability • Terms based on advice from market analysts and middle office
	Monitoring of existing credits	• Project delivery • Contingent liability exposure
Management of domestic arrears (if they exist)	Monitoring role after current securitisation	• Bond terms and pre-transaction analysis) • Assumes arrears are securitised
Relationship with the market	Monitoring of primary dealers (PD) performance	• This includes providing reports for monitoring PD performance
	Intelligence gathering	• Regular meetings with market intermediaries and investors
	Promotion of the market	• Active publication of relevant data on the market on website, etc. • Non-deal road shows – both domestically and internationally
Domestic market development issues	Issuance policy	• Auction techniques • Auction calendar • Benchmark bonds
	Instrument design	• Bond structures • Assessment of market demand
	Market infrastructure	• Relationship with regulators • Relationship with intermediaries • Relationship with providers of physical infrastructure • Transparency

2. Middle office

Function	Sub-function	Comment
Strategy formulation	Strategic debt analyses	• Projections of various issuance scenarios • Analysis of objective, and other, indicators of cost and risk • Stress tests based on various macroeconomic scenarios • Integration with debt sustainability analysis • Coordination with fiscal planning function
	Strategic cash analyses	• Assessment of intra-year cash needs and timing mismatch
	Development of annual financing plans	• Consistent with the approved strategy
	Policy advice to high-level strategic and advisory committees (where they exist)	• Secretariat support to committees
	Liaison with fiscal, budget execution units and central bank	• Receipt of information on projected financing requirements • Outlook for debt in medium and long term • Communication of financing plans and outturns

Coordination with other policies	Monitoring borrowing requirement	• Review of actual outturns against projected financing needs and assessment of implications for future financing plans
	Monitoring of government guarantees and on-lending activities	• To enhance analysis of risk
	Develop and maintain pricing framework for on-lending and deposit taking (if relevant)	• To ensure it is consistent with policy
Reporting	Monitoring and evaluation of strategy implementation	• Preparation of annual debt management report to National Assembly/Parliament • Preparation of internal reports for senior policy-makers • Performance indicators as agreed
	Public communication of strategy	• Other reports to communicate developments in strategic thinking, progress in implementing strategy, etc.
Relationship with other key stakeholders	Liaison with credit rating agencies	• To identify and address any emerging concerns • Maintaining data flows as required (data supplied by back office)
Relationship with agents	Monitoring of performance of central bank and other agents	• Based on 'contract for service'. • A close relationship mitigates operational risk
Operational Risk	Debt recording database and portfolio management systems	• Maintain and ensure kept up to date • Ensure data quality, using appropriate entry and validation procedures, or other security features
	Monitoring of operational risk	• Key procedures to be documented and maintained
Documentation	Prospectuses	• Coordination of preparation and sign-off
	Agreements and contracts with counterparties and creditors	• Interaction with front office
	Necessary congressional processes	• External and domestic borrowing • Debt swaps and other portfolio operations

3. Back office

function	Sub-function	Comment
Confirming transactions and maintaining debt database	Recording all debt transactions, including loans and credits	• Data receipt from front office
	Confirming settlement of all transactions	• Ensuring that cash is credited as planned • Bank account reconciliation • Function differs between marketable debt and credits
Debt statistics	Supply of data to external users	• Domestic and external • Rating agencies

Payment instructions	Debt servicing payments	• Formal instructions to paying agent • Liaison with the budget execution unit, audit and the central bank
Information technology (IT) strategy and operations	IT strategy	• Identify and prioritise medium-term requirements
	Identify other hardware and software requirements	• Telecommunication and other interfaces • Auction system specification and implementation (if done in-house) • Payment system implementation (if done in-house) • Data resources (e.g., Bloomberg, Reuters, etc.)
	Develop DMU website	• Liaise with middle office
	Maintain IT systems	• Debt recording system • Telecommunication, auction, payment, information and website systems • Other IT networks and systems