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## Developing local capital markets in the southern and eastern Mediterranean region

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WITH THE COLLABORATION OF CLIFFORD CHANCE US LLP AND THE EBRD

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This article presents an overview of the current stage of development of the capital markets (debt and money markets) in each southern and eastern Mediterranean jurisdiction (Egypt, Jordan, Morocco and Tunisia), the ongoing reforms and also the areas where changes would be beneficial to encourage the deepening of the market.



## Introduction

Capital market development has always been high on the transition agenda for the majority of the EBRD's countries of operations. In 2010, following the global financial crisis, the EBRD launched the Local Currency and Local Capital Markets Initiative (Initiative), whose aim is to encourage local currency lending as well as the development of local capital markets where local sources of domestic funding can be mobilised, thereby reducing the reliance on foreign currency lending and the related foreign exchange risks, and encouraging local savings. As part of the Initiative, the EBRD conducted an assessment reviewing the legal and regulatory framework necessary to support a vibrant local capital market, against the stage of development of the jurisdiction in question. The assessment was conducted in 10 jurisdictions in the eastern

Europe and central Asia (EECA) region: Georgia, Hungary, Kazakhstan, Mongolia, Poland, Romania, Russia, Serbia, Turkey and Ukraine.

Following the Bank's expansion into the southern and eastern Mediterranean (SEMED) region, the EBRD and its Legal Transition Team, in cooperation with international law firm Clifford Chance US LLP, teamed up with expert local counsel from the region to provide an assessment of the legal and regulatory regime for capital markets activity in SEMED. The ECA assessment's tested methodology was used. This article presents a summary overview of the current stage of development of the capital markets in each SEMED jurisdiction, the ongoing reforms and also the areas where reforms would be beneficial to encourage the deepening of the market. The main focus of the assessment and, therefore, this article, is on the debt and money markets.



**The Companies Law provisions on corporate bonds are neither sufficiently clear nor detailed to create the confidence on the part of companies to issue corporate bonds**

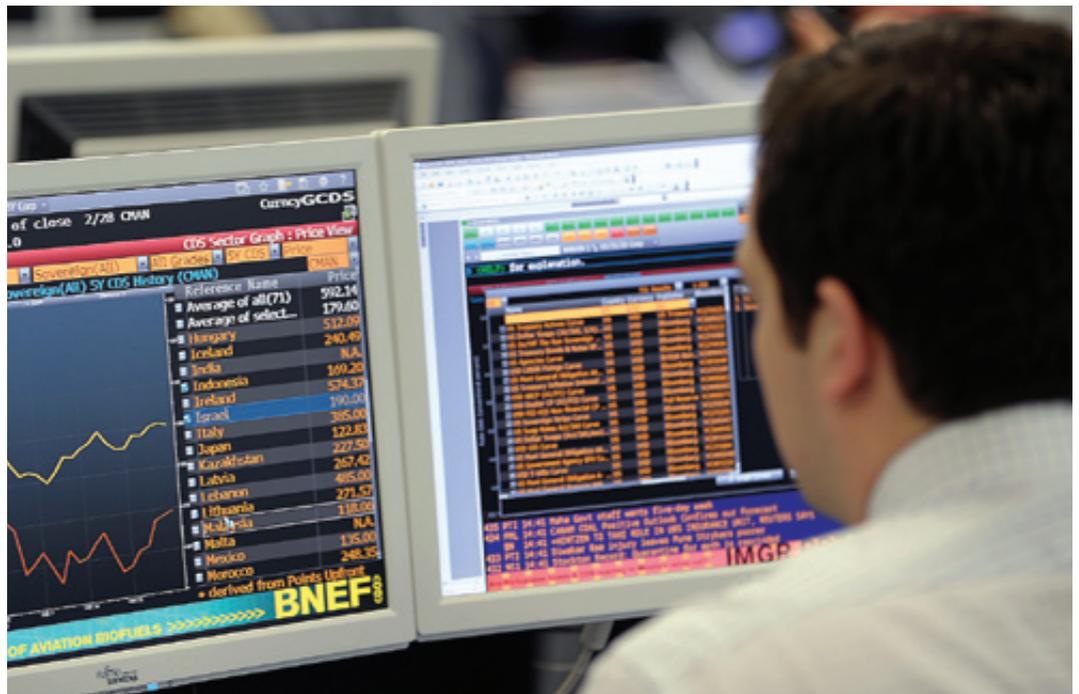
One needs to note that although SEMED countries share to some extent the same culture and language and are partially based on the French civil law system (Morocco and Tunisia, Egypt to a lesser extent), their respective legal frameworks are rather distinct and each jurisdiction is at a different stage of capital markets development and faces different issues hampering such development.

**Jordan**

In Jordan, the primary bodies and institutions which regulate and monitor local capital market activity are the Council of Ministers, the Higher Ministerial Committee for the Management of the Public Debt, the Jordan Securities Commission (JSC) and the Central Bank of Jordan (CBJ).

The laws, regulations and instructions governing securities in Jordan tend to be couched in general terms. This lack of specificity, combined with a general dearth of practical experience by both market participants and regulators, sometimes leads to poor guidance concerning the issuance and regulation by the JSC of debt securities and this uncertainty may contribute to the general low volume of instruments issued.

For example, the provisions in the Securities Law<sup>1</sup> surrounding private placements of securities are unclear as to whether a private placement is defined as one where securities are *placed* with up to 30 investors or *offered* to up to 30 investors. Furthermore, neither the Law nor the applicable instructions offer guidance as to the length of the offering period. Another example of somewhat imprecise provisions can be found in the exemption, provided in the Securities Law, from issuing a prospectus if the securities are sold to an investor who is capable of assessing and bearing the investment risks. However, there is no definition as to who qualifies as such investors and thus, the concept of “qualified investor” is not appropriately defined. Also the Instructions for Registration, Deposit and Settlement of Securities of 2004 do not consistently distinguish between the types of securities and it is difficult to determine which specific provisions are to apply to different instruments, such as equities or bonds. Moreover, the Companies Law<sup>2</sup> provisions on corporate bonds are neither sufficiently clear nor detailed to create the confidence on the part of companies to issue corporate bonds, therefore explaining the low activity in this market. For example, under the Companies Law, on the issuance of corporate bonds,





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an Assembly must be formed and entrusted with the duty of protecting the rights of all bondholders. The Assembly must meet at the outset based on an invitation by the issuing company's board of directors. The Assembly has the right to appoint an Issuance Trustee, which must be licensed by the JSC. However, the Companies Law provides no further guidance on the Assembly's scope of authority or responsibility, particularly with respect to the duty of protection of the bondholders' rights.

Interestingly, the Jordanian parliament has recently adopted an Islamic Finance Sukuk Law No. (30) of 2012 (Sukuk Law), which will expand the variety of debt instruments in Jordan and will enhance the attractiveness of the Jordanian debt capital markets for Islamic market participants. The Sukuk Law allows these bonds to be issued in local currency (Jordanian dinar) or foreign currency; to be issued by government, public institutions, Islamic banks and companies; and to be traded on the Amman Stock Exchange or over-the-counter (OTC). However, the success of this Law will largely depend on implementing regulations, which still need to be developed by the JSC.

The Jordanian money market, including derivatives, is rather nascent, partially because of the lack of legal certainty on derivatives. For example, the definition of "securities" under the Securities Law specifically identifies certain derivatives contracts, namely "spot" contracts and "forward" contracts. Even though the definition also seems to include a catch-all provision which technically allows other types of derivatives to be considered "securities" under the Securities Law, the JSC has deemed the lack of implementing regulations, which allow for the regulation and issuance of derivatives as effectively prohibiting the use of such instruments. In addition, the CBJ has further restricted bank investment in derivatives by issuing instructions to restrict derivative investments by members of these industries. Another difficulty is that engaging in speculative derivatives transactions may qualify as engaging in gambling activities, which would, as in most countries, be illegal and void under the Jordanian Civil Code and under general Jordanian public policy. Because it is unclear to market participants which derivatives transactions would be considered "speculative" under Jordanian law, the use

of derivative transactions in commercial transactions is strongly discouraged.

## Tunisia

Tunisian capital markets are regulated and monitored by the Ministry of Finance (MOF), the Financial Market Council and the Central Bank of Tunisia. While many aspects of the framework that governs local debt markets in Tunisia are still rudimentary, legislative and regulatory reforms are ongoing. Specifically, the Tunisian authorities are currently considering a number of legislative changes, including expanding the types of debt securities instruments allowed as well as the adoption of laws to encourage Islamic finance, including sukuk issuances. The creation of a foreign exchange component in the Tunis Stock Exchange is also under consideration.

The current Law on the Reorganisation of Financial Markets<sup>3</sup> (Financial Markets Law), which was adopted in 1994, has not kept pace with more sophisticated instruments like derivatives transactions. In addition, there is considerable overlap between the Financial Markets Law and other, capital market-related laws, which may cause occasional conflicts and does not provide the clarity and guidance necessary for market participants and for the development of the local capital market. Moreover, the Financial Markets Law defines a "public offering" as an offering to 100 persons or more or an offering of securities which are listed or are to be listed on the Tunis Stock Exchange. This definition with respect to the reference to 100 persons is outdated and could be revised, focusing instead on whether the offering is made only to "sophisticated investors". This definition will also need to be modified to encompass all entities and natural persons that have the expertise, knowledge and skills necessary to undertake investment decisions and evaluate risks relating thereto. The new definition of "sophisticated investor" could, for example, be similar to the one provided by the recently adapted decree No 2012-2945 dated 27 November 2012 implementing Article 23 of Law No. 88-92 of 2 August 1988 relating to investment companies and Article 22d of the Code on collective investment schemes. This definition of "sophisticated investor" encompasses companies that meet a number of defined criteria<sup>4</sup>.



**There are currently several legislative initiatives which are expected to expedite the development of the local capital markets in Tunisia**

There are currently several legislative initiatives which are expected to expedite the development of the local capital markets in Tunisia. First, the Law 2003-49 dated 25 June 2003 is under modification to allow for use of sale and purchase transactions (known as “repo” transactions) by entities other than banks. In addition, a Sukuk Law is under preparation, which would thus expand the variety of debt instruments in Tunisia and would enhance the attractiveness of the Tunisian debt capital markets for Islamic market participants.

The Tunisian derivatives market is very limited and its development has been hindered by the risk that certain derivatives transactions could potentially be unenforceable under the Tunisian Civil Code if qualified as gambling or speculative transactions. Moreover, Tunisian law provides for enforceability of set-off if the conditions of set-off are met, that is, in the case of due and liquidated claims. However, there are no specific provisions on the enforceability of close-out netting contractual terms in insolvency proceedings. Currently, it is not clear under Tunisian law whether the opening of a reorganisation proceeding under the Law No 95-34 dated 17 April 1995 on the reorganisation of companies under financial difficulties would prevent the

operation of a set-off or close-out netting provisions. Thus, specific provisions to confirm that a contractual set-off is valid notwithstanding an insolvency proceeding should be introduced.

There exist a number of regulatory limitations to foreign currency transactions in Tunisia: for instance, participation in Tunisian government bonds or Tunisian equity or debt securities by non-residents is limited. In addition, the Financial Markets Law requires that all debt instruments issuers fulfil certain specific conditions which are generally appropriate for local issuers but are not pertinent to foreign issuers, such as that financial statements of issuers in the local debt market be prepared in accordance with local legislation and that issuers provide additional documents required by the code on commercial companies.

**Egypt**

In Egypt, the primary institutions which regulate and monitor capital markets activity are the Egyptian Financial Supervisory Authority (EFSA) and the Egyptian Stock Exchange (EGX) in relation to corporate bonds and shares, the Ministry of Finance (MOF) and, the Central Bank of Egypt (CBE) in relation to





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government bonds and treasury bills. One of the key areas of the existing legal framework that could benefit from improvement is the current review process carried out by the EFSA of issuing documentation for local debt securities. Market participants view it as very time-consuming and often inconsistent, which is a factor that discourages issuances. To improve the efficiency of this offering process and increase consistency it may be desirable to re-evaluate the documentation which is currently required as well as coordinate the various divisions within the EFSA involved in the review. Moreover, some of the applicable EFSA regulations, such as the one on convertible bonds issuances, may need to be revised as market participants view some of them as not aligned with regulatory practices outside of Egypt and unnecessarily discouraging valid market activity. Similarly, the regulation of repo transactions would benefit from clarification as repo transactions which have not been expressly authorised either by the EFSA or CBE could be unenforceable.

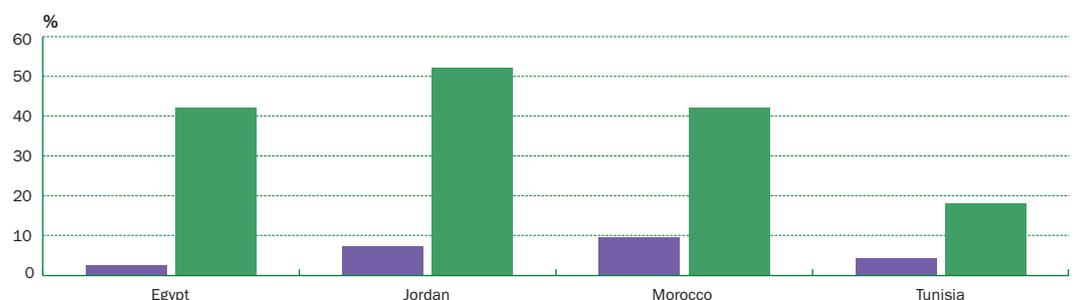
Egypt does not yet have a legal or regulatory framework for the issuance of Islamic securities, and, as a consequence, an Islamic securities market has not developed. While the Capital Market Law<sup>5</sup> provides for the possibility of issuing shares, bonds and sukuk, there are no detailed rules governing the issuance of sukuk and there is no description for the possible underlying structures. A draft regulation on issuance of sukuk is being developed by

the EFSA and adoption of this regulation should improve matters significantly.

The corporate bond market is generally underdeveloped, as is the case in the other SEMED countries (see Chart 1), due to lack of timely availability of price information on OTC trades of government bonds. Due to this price opacity, it is difficult for market participants not involved in a given trade to establish accurate benchmark yield-curves, which corporate bond issuers could use to price their issuances. Real-time price information on trades of treasury bills would be a step forward to facilitate the development of benchmark yield curves.

A recent and positive development in Egyptian capital markets is the discussion on the drafting of a complete new chapter of the Executive Regulations to the Capital Market Law in connection with mutual funds. One of the main advantages of this proposed revised regulation is that, *inter alia*, it would override the currently existing two separate regimes regulating mutual funds depending on when those funds were formed (post- or pre- 2002) and, is therefore, expected to simplify mutual fund management. The most prominent reform proposed in the new draft intends to address previous weaknesses in the regulation, particularly in relation to the corporate structure and legal personality of funds and the lengthy procedures in relation to fund incorporation and offering of fund certificates. In addition, the draft regulations would provide more detail on the activities

**Chart 1**  
**Total volume of the outstanding non-government bonds compared to total volume of the outstanding bonds, in relation to GDP as of January 2013**



■ Non-Government bonds as a % of GDP \*   ■ Total bonds (including treasury bills) as a % of GDP

\* Non-government bonds includes corporates, municipalities and public companies bonds.

Source: Bloomberg; National Exchanges of Egypt, Jordan, Morocco and Tunisia; and the Gulf Bond and Sukuk Association.



**The city of Casablanca has the ambition to become a major financial centre for north and west Africa, through the creation of a new regional financial hub, Casablanca Finance City**

of specific purpose funds and fill in some of the gaps present in the current regulation. However, the unstable socio-political situation in the country at the time of writing means that progress has so far been very limited.

**Morocco**

The primary institutions which regulate and monitor capital market activity are the *Conseil Déontologique des Valeurs Mobilières* (CDVM), the Moroccan stock exchange (Stock Exchange), the Ministry of Finance (MOF), Bank Al-Maghrib (Central Bank) and the *Commission de coordination des organes de supervision du secteur financier* (Joint Supervision Commission). A significant number of important legislative and regulatory reforms of the regulation of capital market activity in Morocco have been undertaken recently. Specifically, some of the primary institutions regulating the capital markets are being reformed to increase their independence and supervisory powers; efforts to introduce Islamic finance products are underway; a draft law on covered bonds is being prepared (more details are provided in “Morocco Covered Bonds Project” by Nouaman Al Aissami and Hicham Talby, at page 62 of this journal); and a draft law establishing a regulated market (under the supervision of the

CDVM and the Central Bank) for the trading of derivatives instruments is being prepared. The Moroccan legal and regulatory framework governing capital markets is currently being reformed and harmonised with the EU *acquis communautaire*, primarily to reflect the best practices that EU law is seen to incorporate. The city of Casablanca has the ambition to become a major financial centre for north and west Africa, through the creation of a new regional financial hub, Casablanca Finance City (CFC)<sup>6</sup>. For the CFC to be successful, the Stock Exchange should be modernised, and in this respect, the Stock Exchange is currently working on a draft law that would expand and update its trading platform to allow for listing of a wider variety of instruments. Also under discussion is the Stock Exchange’s ownership structure, and expediting of the listing process.

Draft laws are under way to amend the Banking Law and the Securitization Law to enable the establishment of participative finance investment vehicles, which would facilitate transactions consistent with the principles of Islamic finance.

The main factor discouraging the access of foreign issuers to the Moroccan debt capital markets is the number of limitations to foreign





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financial transactions. For example, foreign companies must seek prior consent of the MOF for any kind of public offering (either a primary listing of securities on the Stock Exchange or the issuance or sale of securities to the public by way of canvassing or marketing). Furthermore, there are no detailed published rules for this approval process and such applications are considered by the MOF on a case-by-case basis.

Currently, Morocco has no specific legislation authorising or governing the purchase and sale of derivatives instruments, whether on the Stock Exchange or OTC. In the absence of appropriate framework, there is a risk that some transactions might be classified as “gambling” and therefore void. Moreover, automatic set-off allowed by law does not benefit non-resident parties, which have to obtain the prior approval of the Foreign Exchange Office; furthermore, both set-off and close-out contractual terms may be unenforceable in insolvency proceedings. The Draft Derivatives Trading Law being developed by the CDVM to set up a regulated market is expected to provide solutions to these issues. However, at this stage, this draft law does not address the OTC market where most of the transactions take place.

### **Conclusion**

This brief overview shows that SEMED countries share some similar problems hampering the development of capital markets, such as the uncertainty surrounding validity of derivatives transactions and also enforceability in case of one party's insolvency. It will thus be important across the four jurisdictions to introduce concepts of set-off and close out netting, where these concepts either do not exist or are not fully developed. The EBRD has advised and followed the development in this area in a number of countries (most recently in Ukraine, for example), and therefore could assist in this respect.

It is also worth noting that all four SEMED countries are currently exploring the opportunity for, or actively working on, the introduction of Islamic financial products. However, marked differences in development stage and pace of reform are found: in Morocco, for instance, capital market reform is high on the agenda and no less than 12 laws are being developed. In Egypt, the reform process has slowed, despite various issues that need to be addressed. Less developed capital markets jurisdictions, like Jordan or Tunisia, should ensure appropriate sequencing of reforms by addressing basic impediments first, before introducing more advanced instruments.

Lastly, the assessment has also revealed the need to strengthen the various regulatory bodies responsible for the capital markets in the various countries in the SEMED region and to ensure enhanced cooperation among them. This would be of importance in building a more coherent and consistent application of a legal and regulatory framework to market participants and would thus impact positively on investors' confidence in the markets.

## Notes

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<sup>1</sup> The Securities Law No. (76) of 2002 which came into effect on 31 December 2002.

<sup>2</sup> The Companies Law No. (22) of 1997 which came into effect on 15 June 1997.

<sup>3</sup> Financial Law: Law No. 94-117 dated 14 November 1994 on the reorganisation of the financial market.

<sup>4</sup> The decree requires at least two of the following conditions to be met for a person to qualify as a sophisticated investor:

- annual average over 200 people
- balance sheet total of more than 20 million dinars
- consolidated turnover or net income in excess of 40 million dinars

Any individual investor who conducted an initial subscription of at least one hundred thousand dinars and filling at least one of the two following conditions:

- having occupied for a period of at least two years, a position in the financial sector, and has evidence that he has acquired knowledge of managing portfolios securities
- holding a portfolio of securities or for deposits worth equal to or greater than one million dinars

<sup>5</sup> Capital Market Law number 95 of 1992.

<sup>6</sup> <http://www.casablancafinancetcity.com/?ld=89&lang=en>

<sup>7</sup> Input from the Casablanca office of Clifford Chance International LLP was received on the Moroccan part of this article.

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## Abbreviations

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<b>CAPEX</b>	Capital expenditure
<b>CB</b>	Covered bonds
<b>CBE</b>	Central Bank of Egypt
<b>CBJ</b>	Central Bank of Jordan
<b>CBT</b>	Central Bank of Tunisia
<b>CDVM</b>	Conseil Déontologique des Valeurs Mobilières
<b>CEE</b>	Central and eastern Europe
<b>CFC</b>	Casablanca Finance City
<b>CIPE</b>	Centre for International Private Enterprise
<b>CNEA</b>	Comité National de l'Environnement des Affaires
<b>DIFC</b>	Dubai International Finance Centre
<b>EBRD</b>	The European Bank for Reconstruction and Development
<b>EECA</b>	Eastern Europe and Central Asia
<b>EFSA</b>	The Egyptian Financial Supervisory Authority
<b>EGX</b>	Egyptian Stock Exchange
<b>ESG</b>	Environmental, social and governance
<b>ERRADA</b>	The Egyptian Regulatory Reform and Development
<b>EU</b>	European Union
<b>EUIR</b>	European Union Insolvency Regulation
<b>FAO</b>	Food and Agriculture Organisation of the United Nations
<b>GDP</b>	Gross domestic product
<b>GDR</b>	Global Depositary Receipt
<b>ICT</b>	Information and Communication Technology
<b>IFC</b>	International Finance Corporation
<b>IFIs</b>	International Financial institutions
<b>JSC</b>	Jordan Securities Commission
<b>LBO</b>	Leveraged buyout
<b>LC2</b>	Local Currency Capital Markets Initiative
<b>LE</b>	livre égyptienne (French for Egyptian pound)
<b>LLC</b>	Limited liability company
<b>LTP</b>	Legal Transition Programme
<b>LTV</b>	Loan to Value
<b>MCB</b>	Mortgage covered bond
<b>PCB</b>	Public covered bond
<b>MAD</b>	Morocco dirhams
<b>MENA</b>	Middle East and North Africa
<b>MSAD</b>	Ministry of State for Administrative Development
<b>MOF</b>	Ministry of Finance
<b>MSMEs</b>	Micro, small and medium-sized enterprises
<b>OECD</b>	Organisation for Economic Co-operation and Development
<b>OGC</b>	Office of the General Counsel
<b>OTC</b>	Over the counter
<b>PE</b>	Private equity
<b>P-Notes</b>	Participatory notes
<b>SEMED</b>	Southern and eastern Mediterranean
<b>SME</b>	Small and medium-sized enterprise
<b>SOEs</b>	State-owned enterprises
<b>SPV</b>	Special purpose vehicle
<b>PPPs</b>	Public-private partnerships
<b>RIA</b>	Regulatory Impact Assessment
<b>TCC</b>	Turkish Commercial Code
<b>UNCITRAL</b>	The United Nations Commission on International Trade Law
<b>UNECE</b>	United Nations Economic Commission for Europe

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