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SADC – COMESA Bond Market Mapping Study

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Abbreviations

AfDB	African Development Bank
AFMI	African Financial Markets Initiative
ATS	Automated Trading System
BESA	Bond Exchange of South Africa
BNA	National Bank of Angola
BoB	Bank of Botswana
BoT	Bank of Tanzania
BoU	Bank of Uganda
BoZ	Bank of Zambia
BSE	Botswana Stock Exchange
BVDA	Bolsa de Valores e Derivativos de Angola
CBK	Central Bank of Kenya
CBL	Central Bank of Lesotho
CCBG	Committee of Central Bank Governors
CDS	Central Depository System
CDSE	CDS for equities
CISNA	Committee of Insurance, Securities and Non-Banking Financial
COSSE	Authorities Committee of SADC Stock Exchanges
CMA	Capital Markets Authority
CMA	Common Monetary Area
CMC	Capital Markets Commission
CMDC	Capital Markets Development Committee
CMSA	Capital Market and Securities Authority
COMESA	Common Market for Eastern and Southern Africa
CSD	Central Securities Depository
DSE	Dar es Salaam Stock Exchange
DVP	Delivery versus Payment
EAC	East African Community
EASMA	East African Securities Markets Association
EASRA	East African Securities Regulators Association
ECOWAS	Economic Community of West African States
ESMID	Efficient Securities Markets Institutional Development
FMDP	Financial Markets Development Programme
FSB	Financial Services Board (South Africa)
FSC	Financial Services Commission (Mauritius)
FSDPs	Financial Sector Development Plans
IFC	International Finance Corporation
IFMC	Capital Markets Training Institute
LuSE	Lusaka Stock Exchange
MAC	Monetary Affairs Committee
MFDP	Botswana and the Ministry of Finance and Development Planning (Botswana)
MFW4A	Making Finance Work for Africa
MSE	Malawi Stock Exchange

MZE	Mozambique Stock Exchange
NAMFISA	Namibia Financial Institutions Supervisory Authority
NBFIRA	Non-Bank Financial Institutions Regulatory Authority (Botswana)
NSE	Nairobi Stock Exchange
NSSF	National Social Security Fund
OT	Obrigacoes de Tresour (Treasury Bonds)
PD	Primary Dealer
RTGS	Real-time Gross Settlement
SADC	Southern African Development Community
SEC	Securities and Exchange Commission
SIDA	Swedish International Development Co-operation
SSX	Swaziland Stock Exchange
TBC	Titulos de Banco Central (Central Bank Bills)
TISS	Tanzania Interbank Settlement System
ToR	Terms of Reference
USE	Uganda Stock Exchange
WHT	Withholding Tax
ZSE	Zambia Stock Exchange

Introduction

I used to think if there was reincarnation, I wanted to come back as the President or the Pope or a .400 baseball hitter. But now I want to come back as the bond market. You can intimidate everyone. - James Carville (Campaign advisor to President Clinton, Wall Street Journal, February 25, 1993).

The African Development Bank (AfDB), through the African Financial Markets Initiative (AFMI), wishes to support the development of African bond markets. In most African countries, bond markets remain undeveloped, and yet they provide an important potential source of finance for both governments and companies. Prior to developing any initiative to develop African bond markets, the AfDB wishes to establish the status of ongoing initiatives to develop bond markets. The AfDB has therefore commissioned a set of regional mapping studies for the Southern African Development Community (SADC), Common Market for Eastern and Southern Africa (COMESA) and Economic Community of West African States (ECOWAS) regions (Southern, East/Central/North, and West Africa respectively). The aim of the mapping studies is to establish the nature and status of existing bond market development initiatives at national and regional levels, and by international institutions, so as to enable AfDB to avoid duplication of efforts. The studies also aim to identify potential synergies between existing initiatives at country and regional level and the AFMI.

This study was conducted by the USAID Southern Africa Global Competitiveness Hub (Trade Hub) during January-February 2009, following a request by the Making Finance Work for Africa (MFW4A) secretariat. It covers the SADC region, as well as part of the COMESA region[1]. Attention is focused on the larger countries and those where there are established capital markets. A full listing of SADC and COMESA member states in South, Central and East Africa is included at Table 1.

Bond Market Issues – General

The Terms of Reference (ToR) for this study note that:

> *bond markets in most African countries remain underdeveloped and one of the reasons underpinning the inadequacy of these markets is the lack of institutional and operational infrastructure which in turn leads to low levels of liquidity, a narrow investor base, short maturities on the bonds issued and high borrowing costs. This impacts ultimately the competitiveness and breadth of financial products available to both the corporate and retail sectors of the economy.*

The ToR further note that developing bond markets will:

(i) *allow governments to improve the terms at which they borrow in the domestic financial markets and thus reduce dependency on foreign currency*

[1] Due to geographical constraints on the funding of the study by USAID, it was not possible to cover the North African members of COMESA.

denominated debt;

(ii) *increase financing options available to the corporate sector; and*

(iii) *act as a catalyst for the development and stability of financial markets and for regional integration.*

It is well established that large and efficient bond markets play a central role in developed financial markets. Bond markets are important in terms of providing an alternative (to banks) source of debt finance for both governments and companies, especially when large sums are being raised. Bond markets also play a crucial role in the determination of interest rates for longer-term credits. Yield curves across bond and money markets provide important economic information, and while monetary policy is generally implemented through central bank actions in money markets, the existence of a well-functioning bond market is an important link in the mechanism whereby monetary policy is transmitted to the wider economy.

The potential benefits of domestic bond markets has been emphasized during the ongoing "credit crunch", which has resulted in the severe curtailment of access to international financial markets; developing countries therefore face a more difficult task in floating international sovereign or corporate bond issues, and with rising risk-aversion, face higher interest costs. Domestic bond markets therefore provide an alternative funding channel for governments and companies.

While bond markets encompass both government and corporate bonds, the two segments are in many ways quite distinct. Generally government bonds are issued first, and in some ways are a pre-requisite for the development of a corporate bond market given their importance in developing a risk-free yield curve against which corporate bonds can be priced. Government bonds are generally issued to finance budget deficits – although they are sometimes tied to specific public sector development projects – and hence depend on governments' financing needs as well as access to other sources of finance (such as donor funds). Even where both government and corporate bond markets exist, government bonds generally account for the majority of both market capitalization and trading activity.

Methodology

The methodology followed during this study combined several components:

- Collection and review of publicly available information on bond markets (publications, websites);
- A questionnaire survey of key institutions involved in bond market development; and
- Country visits and interviews with key institutions involved in bond market development.

The main publications consulted are listed in the bibliography. Countries and institutions surveyed though the questionnaire are listed in Appendix 1, along with the questionnaire used, while institutions visited/interviewed are also listed in Appendix 1.

Country coverage

The universe of countries for the study included the 24 member states of SADC and COMESA (excluding the two North African COMESA members, Egypt and Libya). Of these countries, seven are members of SADC alone, nine are members of COMESA alone, and he remaining eight are members of both (see Table 1). The study focused on larger countries, those with stock exchanges, and those where information was readily available regarding their bond markets. This led to 14 countries being covered in the study, as shown in Table 2.

Table 1: SADC and COMESA Member States

Country	GDP (US$ mn, 2007)	% of total GDP	GDP per capita (US$, 2007)	Stock Exchange?	Member of SADC?	Member of COMESA?
South Africa	283.1	51.4%	5,916	Y	Y	
Angola	61.3	11.1%	3,756	Y*	Y	
Sudan	46.2	8.4%	1,244	N		Y
Kenya	27.0	4.9%	780	Y		Y
Ethiopia	19.4	3.5%	252	N		Y
Tanzania	16.7	3.0%	428	Y	Y	
Botswana	12.4	2.2%	7,933	Y	Y	
Uganda	11.8	2.1%	381	Y		Y
Zambia	11.4	2.1%	939	Y	Y	Y
Congo, DR	10.4	1.9%	171	N	Y	Y
Mozambique	8.1	1.5%	397	Y	Y	
Madagascar	7.7	1.4%	392	N	Y	Y
Namibia	7.4	1.4%	3,671	Y	Y	
Mauritius	6.9	1.3%	5,496	Y	Y	Y
Zimbabwe	4.7	0.9%	403	Y	Y	Y
Malawi	3.6	0.6%	266	Y	Y	Y
Rwanda	3.3	0.6%	355	Y		Y
Swaziland	2.9	0.5%	2,838	Y	Y	Y
Lesotho	1.6	0.3%	664	N	Y	
Eritrea	1.3	0.2%	271	N		Y
Burundi	1.0	0.2%	125	N		Y
Djibouti	0.9	0.2%	1,111	N		Y
Seychelles	0.7	0.1%	8,600	N	Y	Y
Comoros	0.5	0.1%	729	N		Y

** In the process of being established*

Source: IMF World Economic Outlook database; country websites

Data on SADC and COMESA bond markets is shown in Table 1 and Table 2 below. A fuller discussion of country bond markets is included in Appendix 2.

Table 2: SADC-COMESA Bond Market Data (2008)

	Nominal value outstanding		Value traded		Liquidity			GDP	Market
	Govt bonds	Other [1]	Govt bonds	Other	Govt bonds	Other	Overall		Capitalisation
	US$ mn	US$ mn	US$ mn	US$ mn	(%)			$mn	% GDP
Angola	*2,796*	n/a	n/a	n/a	n/a	n/a		61.3	*4.6%*
Botswana	306	533	39	4	12.8%	0.8%	5.2%	12.4	6.8%
Kenya	4,777	112	1,227	[2]	[2]	[2]	25.1%	27.0	18.1%
Lesotho	0	0	0	0	0	0		1.6	0.0%
Malawi	36	0	0	0	0	0	0.0%	3.6	1.0%
Mauritius	3,330	n/a	n/a	n/a	n/a	n/a	n/a	6.9	48.1%
Mozambique	154	55	2.64	0.66	1.7%	1.2%	1.6%	8.1	2.6%
Namibia	633	246	43	15	6.8%	6.2%	6.6%	7.4	11.8%
Rwanda	25	2	0.9	0.3	3.4%	15.0%	4.2%	3.3	0.8%
South Africa	47,035	41,199	1,923,697	143,935	4089.9%	349.4%	2343.3%	283.1	31.2%
Swaziland	50	10	..	..	..	..	..	2.9	2.1%
Tanzania	650	37	..	..	..	..	..	16.7	4.1%
Uganda	718	43	214	..	29.8%	..	28.2%	11.8	6.5%
Zambia	*1,7220*	268	1.2	0.0	0.1%	0.0%	0.1%	11.4	15.1%

Notes

[1] "Other" includes quasi-government, municipal, parastatals, corporate, banks etc.

[2] data includes both government and corporate bonds

.. close to zero *n/a not available*

Source: country visits and questionnaires; JP Morgan; African Alliance; national stock exchanges

Data in italics are from secondary sources

Discussion of Issues

Generally, the development of bond markets follows a fairly well-established sequence, comprising the following steps (some of which may happen in parallel).

Establishing an appropriate macroeconomic and financial environment. For bond markets to thrive, the macroeconomic environment must be conducive. This includes having a broadly market-based economic system where prices provide appropriate signals and incentives, inflation is held at low-to-moderate levels, the exchange rate is not excessively over- or under-valued, and fiscal policy is sustainable. Monetary policy should ensure that interest rates are neither too high nor excessively volatile.

Establishing an equity market. It is generally necessary to have a functioning equity market and stock exchange prior to developing a bond market. A stock exchange forms an important part of the market infrastructure for bond trading, and also supports the development of an investor base as well as a culture of investing in market-based financial instruments.

Establishing a government bond market. The first part of the bond market to be established is typically the market for government bonds. This reflects the fact that governments are usually the largest borrowers in an economy, and as well that government bonds are usually the most attractive fixed income instruments for investors due to their "risk-free" status. Governments will typically issue bonds fairly regularly, which provides constant stimulation to the market. If appropriately structured, government bonds can provide depth and liquidity to the market, and stimulate the emergence of supportive institutions and infrastructure. It is difficult (but not impossible) to establish a corporate bond market in the absence of a government bond market.

Developing market institutions and infrastructure. An efficient bond market requires a range of institutions and market infrastructure. These include institutions that can handle primary issues and ensure that bonds offered for sale can find buyers at a reasonable price. But more importantly, for a fully developed bond market, secondary market trading should be active. An existing stock exchange with a network of brokers can play an role here, especially when corporate bonds are available. For government bonds, primary dealers (PDs) typically play an important role in both primary and secondary markets. Primary dealers will typically play a crucial role in ensuring the success of primary government bond issues, and have responsibilities for market-making (in the secondary market) through having bonds available sale and quoting two-way (buy and sell) prices. Other important components of market infrastructure include securities depositories (where records of ownership of bonds, which are usually dematerialised, are kept), and settlement and payment systems (for transmitting changes of ownership and related payments).

Developing legal and regulatory frameworks. Bond markets are unlikely to develop unless there are certain legal and regulatory pre-requisites in place. Besides general requirements such as the rule of law and a (at least moderately) well-functioning legal system, there are certain specific requirements for bond markets to develop. These include laws that provide certainty as to the status of bondholders in the hierarchy of creditors in the event of default, and laws relating specifically to asset-

backed securities (where the general legal framework may not be clear). It is also important to have a well-functioning regulatory system, relating to the licensing and supervision of securities markets (stock and bond markets), the licensing and supervision of market participants (such as brokers, pension funds, unit trusts, financial advisors, asset managers, primary dealers etc.), and the approval of bond issues. Regulators have to tread a fine line between ensuring that the regulatory framework protects investors (and issuers) and supports market integrity, while at the same time avoiding a regulatory framework that is so strict that market activity is discouraged and the market does not develop. Regulators and market participants will typically share market development and awareness-raising activities.

Developing an investor base. A bond market cannot function without an effective investor base, both for primary issues and secondary market trading. The investor base comprises banks, institutional investors such as pension funds and insurance companies, foreign investors, and retail investors. Developing an investor base is a long-term process, which depends on the development of the broader financial sector, as well as appropriate liberalisation and regulation. If the pension sector is dominated by statutory funds, the investor base is unlikely to contribute to a vibrant bond market unless fund management is contracted out to independent, competing asset managers. It is also unlikely that a vibrant bond market will develop without the active participation of foreign investors.

Developing skills and capacity. Issuing and trading bonds (and related activities such as pricing) are highly specialised activities that require commensurate skills and capacity in both market participants (brokers, dealers, investors, financial advisors etc.) and regulators. The private sector will develop or hire such skills given adequate financial incentives, but it is also important that the public sector provides sufficient resources for regulators.

Establishing a corporate bond market. The issuance and trading of corporate bonds generally follows once an effective market for government bonds has been established. The latter provides a risk-free yield curve against which corporate bonds (and associated risks) can be priced, as well as stimulating the development of all of the above requirements for an effective market. Other pre-requisites include appropriate pricing of bonds vis-a-vis bank loans, a developed corporate finance advisory capacity, and awareness on the part of corporates of key issues around bond finance. The establishment of a credit rating system for corporates can also assist the development of the corporate bond market.

Building market liquidity, breadth and depth. Once the above requirements are in place market development can focus on extending the market with a broader range of bond issues, and promoting liquidity to deepen the market through trading activity – processes that reinforce each other in a virtuous circle and strengthen the role of the bond market as a vehicle for the deployment of savings and as a source of finance for investment, as well as being an important vehicle for the transmission of macroeconomic signals and the implementation of monetary policy.

Issues & Constraints

SADC and COMESA bond markets can be divided into four groups, according to their level of development in line with the above sequence:

1. Bond markets that are fully developed and have global significance: South Africa;
2. Bond markets that are reasonably well-established, or have been operating for some time: Egypt, Kenya, Zimbabwe;
3. Bond markets that are newly established: Angola, Botswana, Malawi, Mauritius, Mozambique, Namibia, Rwanda, Seychelles, Swaziland, Tanzania, Uganda, Zambia; and
4. Countries intending to establish bond markets: Lesotho.

The issues affecting these countries and markets comprise a number of general issues relating to the development of bond markets, as well as country-specific issues. The constraints to bond market development relate to the implementation of the various steps laid out above[2].

Fully developed bond markets: the **South African** bond market (operated by the Bond Exchange of South Africa) has a well-developed legal and regulatory structure and very good market infrastructure. The market is large (capitalisation equals 31% of Gross Domestic Product - GDP) and extremely liquid (liquidity was over 2000% in 2008). The main issues facing the market include improving liquidity in corporate bonds, dealing with the consequences of the proposed takeover of the Bond Exchange of South Africa (BESA) by the Johannesburg Stock Exchange (JSE), and coping with the volatility induced by inflows and outflows of foreign investment. On the latter point, foreign investment has made a major contribution to improving market liquidity (as well as financing the South African current account deficit), but is highly subject to broader macroeconomic developments and changed perceptions of risk relating to South Africa in particular and emerging markets in general. Recent global financial and economic turmoil has led to an outflow of foreign portfolio investment from the BESA.

Established bond markets: the Nairobi Stock Exchange (NSE) in **Kenya** has been operating since the 1950s and is well established. The bond market is reasonably large (at 18% of GDP) and reasonably liquid (25%). The government bond market is split between the Central Bank of Kenya (CBK), which holds the depository and deals with settlement and payment) and the stock exchange (where all bonds are listed, and all trades must go through NSE brokers). There is no primary dealer system for government bonds and trading is paper-based and slow, and there have been market integrity issues that have undermined confidence in the market. Trading in government bonds is hampered by a lack of consolidation and benchmark issues. There is a moderately active institutional investment sector, although statutory funds dominate. There are very few corporate bonds; the few that do exist are floating rate and there is virtually no secondary market trading. New corporate bond issues are discouraged by competition from syndicated bank loans, a lengthy regulatory and approval process, and a lack of understanding of bond markets amongst potential issuers.

[2] Detailed information on individual country bond markets is provided in Appendix 2.

The **Zimbabwe** Stock Exchange (ZSE) is also long-established and has traded bonds for many years. However, the country's economic crisis, hyperinflation and collapse has destroyed the market for fixed income instruments, and the ZSE was closed for several months in late 2008 and early 2009. Hyperinflation has reduced the value of existing bonds to zero (along with the debt obligations of issuers). Issues related to the bond market are at this time subsidiary to more pressing macroeconomic stabilisation and recovery issues.

Egypt is not covered in this report.

Newly-established bond markets: these vary considerably in their stage of development. The **Mauritius** bond market is relatively large (at an estimated 48% of GDP). It is dominated by government bonds and there are few corporate issues, and liquidity is generally low. **Namibia** also has a relatively large bond market (12% of GDP) but low liquidity (7%); it too is dominated by government bonds. Generally there is considered to be a shortage of government bonds (in recent years there has been a fiscal surplus) and hence "buy and hold" strategies predominate. The **Botswana** bond market is quite small (7% of GDP) and has low liquidity (5%). As in Namibia, there is a shortage of government bonds due to budget surpluses and the government's lack of need for bond finance, and hence a "buy and hold" strategy by institutional investors. Government bonds are managed by the Bank of Botswana (BoB) and trades are reported to the Botswana Stock Exchange (BSE), while corporate bonds are handled entirely by the BSE. There are concerns about whether the primary dealer system for government bonds is working effectively, and whether the brokers have sufficient incentive and capacity to undertake bond trading. The distinguishing feature of the Botswana bond market is the large number of non-government bonds (comprising bonds issued by corporates, parastatals and other quasi-government institutions). Capitalisation of these bonds exceeds those of government bonds, although secondary market activity is dominated by government bonds and liquidity in non-government bonds is virtually non-existent. Issuance of non-government bonds was stimulated by the issuance of government bonds – which was purely for market development purposes – and the establishment of a risk-free yield curve. There is a large institutional investor sector, with recent growth stimulated by the establishment of a funded, defined-contribution pension scheme for public sector employees; pension funds are required to invest a minimum of 30% of their assets locally.

Angola has an embryonic bond market with a number of government bonds denominated in both local currency and US dollars. However, the market is somewhat distorted by the exchange rate and monetary policy regime, which comprises a pegged exchange rate and managed interest rates, and which can sometimes yield inconsistent price signals. Angola is intending to establish a stock exchange during 2009. However, the Angolan economy is heavily government-controlled, and market processes are weak. The institutional investor sector is undeveloped, and foreign participation in the bond market is highly restricted.

In **Uganda**, the bond market shows a stark contrast between a moderately active government bond sector and almost non-existent corporate bond sector. While the market is not particularly large (6% of GDP) it is highly liquid by the standards of the

region (28%). The market is new, but is hampered by fragmentation of government bonds and a lack of benchmark issues. A primary dealer system exists for government bonds but there are mixed views about its effectiveness. The Bank of Uganda (BoU) handles the government bond market, with trades reported to the Uganda Securities Exchange (USE), while the USE handles corporate bonds. The pension sector is dominated by statutory funds and the private asset management sector is tiny. Foreign investors are permitted, and have been important in building market liquidity. The development of corporate bonds is hampered by a lack of capacity and understanding in the corporate sector, perceptions that bond issues are expensive and difficult, and competition from bank loans. **Tanzania** has a very small bond market (4.1% of GDP), dominated by government bonds, and with virtually no secondary market activity. The Bank of Tanzania (BoT) handles government bonds, although trades have to be booked through the Dar Stock Exchange (DSE), which handles corporate bonds. The market is new, but is hampered by fragmentation of government bonds and a lack of benchmark issues. There used to be a Primary Dealer system, but it was suspended following concerns that it was ineffective. The pension sector is dominated by statutory funds and the private asset management sector is tiny. Foreign investors are not permitted in the bond market. The development of corporate bonds is hampered by a lack of capacity and understanding in the corporate sector, perceptions that bond issues are expensive and difficult, and competition from bank loans.

Malawi has a very small and embryonic bond market, with just one central bank bond, issued in 2008. The bond is issued and managed by the Reserve Bank of Malawi (RBM), and will be listed and traded on the Malawi Stock Exchange (MSE). There are no corporate bonds. **Mozambique** also has a relatively new bond market, with six government bonds and nine corporate bonds in issue. The market is small (3% of GDP) and liquidity is low (1.6%). The development of the government bond market is inhibited because the government has access to concessional donor funds. Corporate bonds are inhibited by the lack of expertise in the market and competition from bank loans. The bond market falls under the Mozambique Stock Exchange, which promotes the development of both government and corporate bond markets. **Zambia** has a large number of government bonds in issue, although the bond market is of medium size (15% of GDP), it is highly illiquid (0.2%). The government bond market is run by the Bank of Zambia, through primary dealers, although there are concerns about the effectiveness of the PD system. The government bond market is fragmented, with a lack of benchmark issues which contributed to the lack of liquidity.

The remaining markets are very small. **Rwanda** has three government and one corporate bond, with capitalisation amounting to 0.8% of GDP. A newly-established stock exchange is hoping to develop the bond market, under the auspices of the Capital Markets Advisory Committee (CMAC). The **Seychelles** has a limited bond market with a few government bonds; there is no stock exchange. The country is in default on an international sovereign bond. **Swaziland** has two government and seven corporate bonds in issue, with capitalisation amounting to 2% of GDP. The bonds are traded through the Swaziland Stock Exchange (SSX), but liquidity is very low. **Lesotho** has no government bonds, but is intending to commence bond issues in the near future. There are no active capital markets in Madagascar, Burundi or the Democratic Republic of Congo.

Regulatory issues

Regulatory environments very considerably across SADC and COMESA in terms of both the structure and capacity of regulators. In most countries, central banks play a key role in government bond markets, through handling primary issues/auctions and appointing primary dealers. Trading regimes vary: in some countries government bonds trade on an Over-The-Counter (OTC) market, with trading and settlement handled by the central bank and reporting of trades to the stock exchange. In other countries, OTC markets do not exist and listing regulations require that all trades go through accredited brokers and the stock exchange.

Beyond this, there are major differences in regulatory structures between Southern and Eastern Africa. Southern African countries tend to have "universal" non-bank regulators (such as the Financial Services Board (FSB) in South Africa, Namibia Financial Institutions Supervisory Authority (NAMFISA) in Namibia and Non-Bank Financial Institutions Regulatory Authority (NBIFIRA) in Botswana). East Africa tends to have "fragmented" non-bank regulators, with separate regulators for securities markets, pension & provident funds, and insurance activities (this is the structure in Kenya, and seems likely to be followed in Tanzania and Uganda). On the face of it, the fragmented structure seems less desirable, especially in small economies, as it is likely to lead to higher costs (regulatory agencies have considerable fixed costs), a worsening of skill shortages, information gaps, and "turf battles" between regulators (and between their parent government departments). It is unlikely that fragmented regulators will help bond markets develop.

Generally, regulators perform a difficult role. They are typically short of resources, and being tied to government pay scales often cannot recruit the most talented individuals, who can usually earn more money in private financial institutions. In the consultations conducted for the preparation of this report, concerns were frequently expressed that regulators lacked the necessary capacity. In many countries, regulatory structures are being developed from scratch, while innovation takes place in financial markets and instruments. In several countries, regulations developed for equity markets are applied to bond markets, even though they are often not appropriate. Regulators often have to perform a dual role, that of market development and risk mitigation/consumer protection, and these roles can be difficult to balance. An excessive focus on risk mitigation and the protection of retail investors, perhaps through the application of equity market regulations to bond markets, can lead to excessive costs of bond issues and inhibition of the corporate bond market.

Issues and Initiatives

The review of SADC and COMESA bond markets – which primarily comprise developing or "frontier" markets – indicates that there a number of common problems. With regard to government bond markets, the most common problems are:

- Fragmentation of the market (an excessive number of bonds in issue), with no benchmark bonds and insufficient liquidity in each of the issues;

- Lack of government bond issues, typically because governments either run budget surpluses, or have access to concessional donor funds at much lower costs;
- Dissatisfaction with the primary dealer system, with concerns amongst issuers (typically central banks) that PDs do not discharge their market making function, and concern amongst PDs that there are insufficient financial incentives for them to invest in the skills, systems and capital needed to effectively discharge market-making functions;
- Lack of issuance programmes, so that potential investors (and PDs) cannot anticipate the future supply of securities;
- A predominant "buy and hold" strategy by investors.

With regard to corporate bonds, the main concerns are:

- A lack of corporate issues, reflecting:
  - Competition from bank loans (often syndicated), which in turn reflects conflict between the dual roles of banks, i.e., seeking lending opportunities and developing the bond market;
  - Underdeveloped corporate advisory services; and
  - Excessive costs of issuing bonds, and restrictive conditions set by regulators.

- Very low liquidity, reflecting:
  - Buy and hold strategies amongst institutional investors;
  - Lack of capacity amongst brokers for bond pricing and trading activities;
  - Lack of capital for market-making activities; and
  - A predominant "buy and hold" strategy by investors.

In many countries, both government and corporate bond markets are constrained by a narrow investor base, which may reflect the institutional investment sector being dominated by government-run statutory funds and a legal framework that does not encourage the emergence of private pension funds and asset managers, and/or restrictions on the entry of foreign investors. Other constraints include withholding tax (especially when applied to foreign investors, when it typically becomes a final tax); asymmetry in taxation regulations applying to government and corporate bonds; and high transactions costs.
Regional capital market integration initiatives face other constraints, including the slow pace of harmonising national legislation and regulations; a lack of political commitment to regional integration and unwillingness to sacrifice national sovereignty; the impact of exchange control regulations on capital movements.

Bond Market Development Initiatives

A number of initiatives are under way to develop bond markets in the SADC and COMESA regions, including both national and regional initiatives.

The most developed regional initiatives are probably those taking place in the East African Community (EAC). These include:

- The formulation of Financial Sector Development Plans (FSDPs) by national governments, under the auspices of the Monetary Affairs Committee (MAC)

of the EAC; all FSDPs follow a common agreed methodology, and are focused on achieving deep and efficient financial sectors within the context of harmonised regulatory frameworks and progressive regional integration of capital markets;

- A regional body of stock exchanges (the East African Securities Markets Association, EASMA);
- A regional body of securities markets regulators (the East African Securities Regulators Association, EASRA), under which listing rules for equities and bonds across the EAC are being harmonised;
- A project to link national securities markets through an integrated trading system that will provide visibility and access to trading platforms across the region for brokers from each country;
- US Treasury support for the development of government bond markets in East Africa
- The development of a common syllabus for the professional certification of securities markets professionals in the EAC, which it is hoped will lead to a single licensing requirement that will allow brokers to trade in markets across the EAC (under ESMID – see below); and
- The Efficient Securities Markets Institutional Development (ESMID) initiative, a partnership between Swedish International Development Co-operation (SIDA), the International Finance Corporation (IFC) and the World Bank. ESMID works with securities markets in Kenya, Tanzania, Uganda and Rwanda, and its programme has five components:
    - Assistance to regulators (improving the approval process; reducing costs; developing frameworks for new products);
    - Strengthening the marketplace (reforming market structures; improving secondary market liquidity);
    - Capacity building/training (certification; training on bonds);
    - Regionalisation (broadening and deepening regional markets; harmonisation)
    - Processing transactions (support for replicable transactions, new and innovative products).

The ESMID initiative is relatively new pilot project that has still to undergo its first review. However, initial impressions are that the initiative is well structured and targeted; many of the issues that are being addressed are common across countries (e.g., the need for capacity building), and there is significant potential for economies of scale and delivering much needed technical support across a range of countries.

At a national level, bond market development activities include:

- Reforming the government bond system, including the consolidation of bonds into benchmark issues, re-opening of issues instead of always issuing new bonds at auctions, in order to focus trading on a small number of benchmark issues and promote liquidity;
- Improving trading and settlement systems, and reducing risk;
- Promoting greater transparency in primary and secondary bond markets;
- Building links between issuers and regulatory authorities and market participants (such as the Market Leaders Forum in Kenya, and the proposed Bond Dealers Associations in Uganda and Tanzania);

- Reforming primary dealer systems, so as to enhance incentives for PDs (whether by giving underwriting privileges, or developing incentives that would mimic such privileges) and strengthening the effective discharge of PD responsibilities, e.g. in market making;
- Marketing and awareness raising campaigns to encourage corporate bond issues;
- Legal and regulatory reforms, and shifting the balance of regulatory activities away from minimising risk and towards facilitating market development;
- Considering the issuance of infrastructure and municipal bonds – although this requires considerable preparatory work to establish appropriate legal structures and reform of financial capabilities of parastatals and municipalities; and
- Liberalisation of pensions sectors. The pensions sectors in Uganda and Tanzania are dominated by statutory provident funds that all employers must contribute to. These funds are parastatals and are generally run in a conservative manner without active asset management, and leave little space for private pension funds or the development of a private asset management industry. There is also a lack of regulatory structures for pension funds, although this gap is being addressed by legal reforms and new regulatory bodies in both countries, and it is anticipated that this could result in a liberalisation of pension sectors that will encourage the development of more active asset management and private pension funds.

Southern Africa operates quite differently and is in many ways less integrated than East Africa. On a regional level, the BESA offers support for developing bond markets, an offer that has been taken up by Namibia and Zambia. SADC stock exchanges also have a harmonisation initiative through the Committee of SADC Stock Exchanges (COSSE). A study has been completed on the harmonisation of equity listing rules cross COSSE members, but the same has not yet been done for bonds. COSSE is also promoting a project to link SADC stock exchanges and facilitate cross-border trading of equities and bonds. SADC has established a Capital Markets Development Committee (CMDC) under the auspices of the SADC Committee of Central Bank Governors (CCBG); the CMDC is expected to commence work in February 2009. The SADC Committee of Insurance, Securities and Non-Banking Financial Authorities (CISNA) aims to harmonise the regulatory frameworks for securities markets across the region. The CCBG has a Payments systems Initiative, which has promoted and harmonised the development of national payment systems, with a view to the eventual development of a regionally integrated payments system. The SADC Development Finance Resources Centre (DFRC) has been running a project to promote credit ratings for Development Finance Institutions (DFIs), which will facilitate the raising of finance on bond markets by DFIs[3].

At a national level, common programmes include:

- Reviewing and reforming legal and regulatory regimes;
- Capacity building among market participants;
- Ensuring that information dissemination on bond trading is improved, and building links between trading activities for government bonds and stock exchanges; and

[3] The pilot project involves credit ratings for DFIs in Botswana, Namibia and Mauritius

- Engaging with suitable corporate and parastatal entities to encourage bond issuance.

Conclusions

Apart from South Africa, all SADC and COMESA bond markets reviewed need considerable development work in order to make them effective and efficient sources of capital for investment by both governments and the private sector, and competitive destinations for savings. This applies to both countries that have existing bond markets and countries that are developing them from scratch. The starting point of this development work is to improve the efficiency of the government bond segment of the market in order to boost liquidity and provide an effective risk-free yield curve, which can stimulate the emergence and development of the corporate bond segment.

Ongoing development challenges cove all facets of the bond market: developing benchmark government bonds; improving market infrastructure such as trading and settlement systems; reforming the legal and regulatory frameworks; improving the skills and capacity of market participants and regulators; improving awareness and understanding of bond markets; developing the investor base, especially of domestic institutions and foreign investors; and removing impediments to cross-border transactions and promoting regional capital market integration.

Many of these tasks are similar across countries and markets. Nevertheless, many ongoing bond market development initiatives are being undertaken at a national level, and are hampered by a lack of financial and human resources. This may not be the most efficient approach, in view of the high costs involved, and there are likely to be benefits to be gained from undertaking a regional approach. The ESMID pilot project in East African provides a very useful example of such a regional approach. Although the project has only been operating for a short time, it is yielding benefits in two different areas. First, preliminary indications are that ESMID delivers capacity building and support for market development in a cost-effective manner, through exploiting economies of scale in dealing with groups of countries and markets where there are common or similar needs and issues. Second, by building regional harmonisation and market integration into its approach, ESMID contributes to the prospect of a regionally integrated capital market. This should in turn be more likely to achieve critical mass, build broader, deeper and more efficient markets, offer efficiency benefits, and stimulate a more efficient allocation of savings and investment in the EAC region. Subject to the results of the mid-term review of ESMID due to take place later in 2009, consideration should be given to extending the project to other regional groupings. The SADC countries would be an obvious location to consider, given the similarities of needs across SADC bond markets – even if those similarities may be somewhat less than in the EAC. However, a SADC ESMID would potentially have the advantage of leveraging off of the experience of the highly developed bond market in South Africa, and the potential assistance that the BESA could offer to bond market development in the region.

APPENDIX 1

Institutions returning the completed questionnaire

Country	Institution
Lesotho	Central Bank of Lesotho
Malawi	Malawi Stock Exchange
Mauritius	Stock Exchange of Mauritius
Mozambique	Bolsa de Valores (Mozambique Stock Exchange)
Namibia	Namibian Stock Exchange
Zambia	Lusaka Stock Exchange; Securities and Exchange Commission

Institutions visited/consulted

Country	Institution
South Africa	Bond Exchange of South Africa
	African Alliance Securities
	Fitch Ratings
Botswana	Botswana Stock Exchange
	Bank of Botswana
Kenya	Nairobi Stock Exchange
	Capital Markets Authority
	Central Bank of Kenya
	Kenya School of Monetary Studies
	African Alliance
	Sanlam Investment Management
Uganda	Uganda Securities Exchange
	Capital Markets Authority
	Bank of Uganda
	African Alliance
	Standard Chartered Bank Uganda
Tanzania	Dar Stock Exchange
	Capital Markets and Securities Authority
	Bank of Tanzania

Bond Market Questionnaire

Data on the Domestic Bond Market

1. Please provide information on the domestic bond market for 2008

1a. Local Currency Bonds

Type of Bond	**Number of Bonds in Issue**	**Total Market Capitalisation**	**Total value traded (2008)**
Government			
Quasi-government /parastatal			
Private sector (corporate)			
Foreign entities			
TOTAL (All bonds)			

1b. Foreign Currency Bonds

(Please state currency_____)

Type of Bond	**Number of Bonds in Issue**	**Total Market Capitalisation**	**Total value traded**
Government			
Quasi-government /parastatal			
Private sector (corporate)			
Foreign entities			
TOTAL (All bonds)			

2. Institutions involved in the Bond Market

Please outline the role (if any) of your institution in the development of the Bond Market in XXXXX

Type of institution and main functions	
Role in Bond Market	

Please provide an organisational charts for your institution (if available), or a website link.

3. Constraints to Bond Market Development

Please outline what you consider to be the main constraints to the development of the Bond Market in XXXX.

Most important constraint
Other constraints

4. Bond Market Development Initiatives

Please outline the main initiatives (if any) that your organisation is taking to develop the bond market (with specific reference to the following topics).

[If any separate documents are available, please attach or include a website reference]

Developing the Legal and Regulatory Structure
Encouraging Issuance of New Bonds
Improving the Trading Environment (e.g. primary dealer system, settlement, market information, credit ratings)
Capacity building / training (for regulators, issuers, market participants etc.)

Regional co-operation / harmonisation / market integration
Other

5. Resources

Please outline the financial and human resources available for Bond Market available in XXXX.

6. Institutional and Regional Collaboration

Please provide information relating to any linkages that you have with other institutions (domestic or regional) regarding Bond Market Development in XXXX.

Domestic Linkages
Regional Linkages

THANK YOU FOR YOUR TIME AND ASSISTANCE

APPENDIX 2: Detailed Country Reports

Angola

Markets exist for Central Bank Bills (TBC - Titulos de Banco Central) and Treasury Bonds (OT – Obrigacoes de Tresour). TBCs are issued by the National Bank of Angola (BNA) for monetary policy purposes, with maturities from 14 to 364 days. Although TBCs are issued at auction, interest rates are in practice determined by the BNA.

OTs are issued by Government on a monthly basis to finance designated budget requirements, with tenor from 1 year up to 12 years. Bonds are issued in both local currency (kwanza) and US dollars. However, the Treasury sets the interest rate administratively on most of these obligations, and instructs BNA to issue the securities on pre-defined terms. Hence, these yields, like the yields on TBCs, do not provide market-driven price signals. The yield curve is therefore administratively determined rather than market determined, and hence provides a limited basis for pricing other securities. Interest rates on kwanza-denominated OTs have been well below the rate of inflation (thereby providing a negative real return), although those in USD-denominated OTs have been closer to market rates.

The markets for both sets of instruments is generally restricted to local investors. The main holders are the central bank, commercial banks, local pension funds, and mining and oil companies. Non-residents are discouraged from entering the market for TBCs, although may be invited to participate in auctions for OTs.

To date, companies in Angola have had virtually no recourse to long term financing by issuing bonds (or stocks) to the public. Even the market for private placements, which one might expect to flourish under these circumstances, has been all but moribund. This may be due to fundamental factors such as the absence of audited financial statements even for most large companies, a lack of long-term savings from pension and insurance funds and booming returns in the real estate market.

To begin the process of capital market development, the Government passed a Capital Markets Act in 2006, establishing a national stock exchange, the Bolsa de Valores e Derivativos de Angola (BVDA). The Act also established a Capital Markets Commission (CMC) as the regulatory authority for the stock exchange and related financial service provides such as brokers, traders, and mutual fund managers. Senior managers for the BVDA and the CMC have been appointed and plans are well advanced for completing the regulatory framework according to international standards, and opening the stock exchange in 2008. BVDA management is already in the process of creating an electronic trading system, developing plans for an impressive new physical venue, and soliciting expressions of interest from both borrowers and lenders. They are also providing basic training to staff and interested market participants through a new Capital Markets Training Institute (IFMC), with courses offered by faculty from many partner countries. BVDA and CMC are also sending staff on study tours to Brazil, Portugal, South Africa, the United States, Spain, and Mozambique. In addition, the Bolsa has already initiated an information campaign to educate the public about capital markets. In short, both the Bolsa and the CMC are systematically putting in place the essential building blocks for opening

the market. But the prospects for success hinge on the actual supply and demand for securities in Angola.

Any significant volume of corporate bond issues probably requires the prior placement of government bonds with a range of maturities, as a pre-requisite for establishing a risk-free yield curve as a benchmark for pricing other securities. This will in turn require transparent pricing of OTs at primary auctions, as well as the encouragement of secondary market trading.

Sources: Developing the Supply of Financial Services and Improving the Efficiency of the Banking Sector in Angola, prepared by Southern African Global Competitiveness Hub for USAID, January 200.

Botswana

Bond market capitalisation

Type of Bond	No. in issue	Market Cap, end-2008 (Pmn)	%	Market Cap (US$mn, approx)
Government	3	2300	36.5%	300
Quasi-govt	15	1815	28.8%	250
Corporate	17	1505	23.9%	200
Non-Resident	4	685	10.9%	100
Total Bonds	**40**	**6305**	100.0%	**850**

Bond market trading activity

Type of Bond	Turnover (P mn, 2008)	Liquidity	% of total trading	Turnover ($ mn, 2008)
Government	293.9	12.8%	90.1%	43.4
Quasi-govt	4.4	0.2%	1.3%	0.6
Corporate	27.8	1.8%	8.5%	4.1
Non-Resident	0.0	0.0%	0.0%	0.0
Total Bonds	**326.0**	**5.2%**	**100.0%**	**48.2**

The Botswana bond market is one of the more developed in SADC outside of South Africa, with a range of government, quasi-government and corporate bonds. However, bond market development is relatively recent. For many years it was hindered by the lack of government bonds in issue; the Botswana government generally runs a budget surplus, and with substantial accumulated financial balances has no fiscal need to borrow. Nevertheless, the Government was persuaded that it was necessary to issue bonds in order to stimulate market development, and in 2003 it issued the first sovereign domestic debt, with maturities of 2, 5 and 10 years. In 2004, the Government also issued a range of quasi-government bonds through a parastatal entity (DPCF), with maturities up to 21 years. In 2008, the Government also issued a Treasury Bill, and committed to undertake regular bond issuance.

While the initial impact of government bond issuance was good, the fact there were no further government bond issues until 2008 weakened the market.

The issuance of government and quasi-government bonds helped to establish a risk-free yield curve extending out to 20+ years maturity, which in turn has underpinned the issuance of bonds by other entities. The commercial banks have been particularly active issuers, taking the opportunity to strengthen their balance sheets through the issue of bonds which qualify as Tier II capital (and which therefore contribute to capital adequacy requirements under Basle rules). Other active issuers include parastatal (government-owned) financial institutions and utilities companies. Capitalisation on the bond market was around US$850 million at the end of 2008 (P6 305 million), with government accounting for 37%, quasi-government & parastatal issuers 29%, corporates 25%, and non-resident issuers 11%. Even now, with newer bond issues, the market remains small.

The market for bonds is, however, dwarfed by the market for central bank paper (with maturities of up to 364 days). Bank of Botswana Certificates are issued for monetary policy purposes, and are restricted to Botswana-registered commercial banks only; foreign participation is not allowed.

Turnover in the bond market is relatively low, with liquidity (turnover/market capitalisation) of 5.2% in 2008. The majority of trading was in government bonds, accounting for 90% of total turnover, with liquidity of 12.8%; relative to their level of capitalisation, quasi-government and corporate bonds saw low levels of trading. Trading is sporadic; for instance, in 2007 there were ten months of the year with no trading in government bonds, while in 2008 there were four months with no trades.

While the issuance of government/quasi-government bonds helped to establish a yield curve, trading on the secondary market remains generally thin, and hence the yield curve is not very responsive to changing economic conditions. In other words, points on the yield curve are market-determined at the time of primary bond issuance but not at other times. Since 2008, government bond auctions have been scheduled at six-monthly intervals (i.e., there is now a regular bond issuance programme, but auctions remain infrequent).

Holdings of government bonds are dominated by institutional investors, with relatively small holdings by the banks (primary dealers) for their own account. The bond market (and indeed much of the equity market) is characterised by “buy and hold” strategies on the part of local institutions such as pension funds and life insurance companies. There is substantial excess demand for bonds, especially government bonds, and institutions are concerned that if they actively trade bonds they may be unable to re-establish their positions. A much larger government bond issue programme is needed to balance supply and demand, and hence promote liquidity.

Category of Holder	Bonds	T-Bill	Total	Total
	P mn	*P mn*	*P mn*	*Percent*
Primary Dealers (Banks) (Own account)	265.9	80.9	346.8	15.8
Commercial banks – client holdings	1594.1	199.1	1793.2	81.5
Bank of Botswana	40.0	20.0	60.0	2.7
Total	1900.0	300.00	2200.0	100.0

Source: BoB

There are no restrictions on the participation of non-residents in the bond market. However, the existence of a Withholding Tax (WHT) on interest discourages foreign participation, as does a lack of transparency with regard to exchange rate policy.

The Botswana Stock Exchange is undertaking an active Bond Market Development Strategy, aimed at addressing the major constraints to bond market development in Botswana. The BSE has established a Bond Market Task Force including the Exchange, Primary Dealers, Brokers and Asset Managers, which is expected to commence work in February 2008. These issues being addressed include:

Lack of local credit ratings: establishing appropriate risk premia (vis a vis the risk-free Government bond yield curve) would be assisted by credit ratings for local issuers. However, there is no local ratings agency and the establishment of a local (Botswana-specific) ratings scale requires a minimum number of issuers, and high fees could be a disincentive. This is being tackled through awareness-raising and potentially through a strategic alliance with a South Africa ratings agency.

Market Infrastructure & Legislation: shortcomings have been identified in the BSE's listing rules (which are biased towards equity), including a lengthy period to approve listings and an unduly long settlement cycle. The rules will be revised to facilitate bond listings. There is also a need to develop specific legislation, particularly with regard to securitisation. There is an active programme of investment in IT systems; a Central Securities Depository (CSD) has been establish that can accommodate bonds as well as equities, and an Automated Trading System (ATS) has been proposed that will incorporate a bond trading system.

Yield Curve and Market Liquidity: low levels of liquidity have hindered the development of an effective yield curve. The announcement by Government of an issuance calendar for bonds and T-bills in 2008 will go some way to help. However, the general shortage of bonds – leading to the buy and hold strategy by individuals – will prevail unless the scale of government bond issues is substantially increased – essentially the market needs to saturated before the institutions will trade actively. In addition, further work is needed on the centralisation of information on bond market trading, as there is at present no mechanism for ensuring that all government bond trades carried out by primary dealers are reported to the BSE. There is also a need to establish a benchmark bond market index for the BSE. Liquidity may also be assisted by raising transaction ceilings amongst primary dealers.

Information and Awareness Raising: there is generally very limited awareness of bond market issues amongst the general public and even amongst the broking

community and potential issuers. Hence the BSE has embarked upon an awareness-raising strategy, commencing with a seminar on Bond Market Development in October 2008. A seminar on credit ratings has also been held.

Key institutions involved in bond market development in Botswana are the BSE (which is driving the development of the corporate bond market) and the Bank of Botswana and the Ministry of Finance and Development Planning (MFDP), which are driving the development of the government bond market. The MFDP also provides resources to the BSE, both for recurrent costs and for infrastructural development such as the establishment of the CSD. The Non-Bank Financial Institutions Regulatory Authority (NBIFIRA), which as its name implies is the regulator for all non-bank financial institutions including the BSE, pension funds, asset managers etc., was only established in April 2008, and is not yet playing an active role in bond market development.

Sources: Botswana Stock Exchange; Bank of Botswana; personal interviews

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Kenya

Type of Bond	No. in issue	Market Cap, Dec-2008 ($mn)	%	Turnover (2008)	Liquidity
Government	74	4777	97.7%	n/a	n/a
Corporate	11	112	2.3%	n/a	n/a
Total Bonds	**85**	**4889**		1227	25.1%

The Kenyan bond market is considered to be one of the more developed in the SADC/COMESA region, and is certainly the most developed in East Africa. Government bonds have been issued since 2003, and there are a large number of bonds in issue. The corporate bond market is relatively undeveloped however, with only 11 listed bonds, from eight issuers.

Government bonds are issued primarily for the purposes of funding the budget deficit. However, government has also attempted to use bonds to develop the capital market. Funding has shifted from initially being based on short-term Treasury Bills towards bond funding. Maturities have been extended to develop the yield curve, and now extend out to 20 years. The CBK acts as agent for the Treasury in bond issuance. Bond auctions are held monthly. The CBK runs the Central Depository System (CDS) for bonds.

The broader capital market is well-developed. The NSE has been existence since the 1950s. There is a well-developed network of brokers, asset managers, pension/provident funds and insurance companies, all active in the market. The pension/provident fund sector is dominated by the statutory National Social Security Fund (NSSF). However, there are a number of private pension funds and asset managers. The NSE has an Automated Trading System (ATS) and CDS for equities (CDSE). Retail investors are also relatively active. The Treasury and the CBK have been actively engaging with market participants, through the Market Leaders forum, to determine best methods of developing the market. Government bonds are listed

on NSE and can only be traded through brokers. Foreign investors are permitted, and there is active retail participation by retail investors.

Secondary market trading is reasonably active, and market liquidity is relatively high at 25%. Nevertheless, it is considered that the market has several weaknesses, including:

- There is no primary dealer system, no market making or two-way quotes.
- A lack of transparency – the CBK does not fully disclose auction results (e.g. it does not disclose cut-off price); the government bond auction calendar is not public, but is disclosed to major market participants. Government bonds are listed on the NSE but the NSE website does not include bond information.
- Government bonds are not included in the ATS. Trading is paper based and processes are lengthy. Anybody wishing to trade bonds has to first get ownership verified by CBK, which can take time. Once verification is done, trade begins and settlement is T+5.
- Government bond issues are fragmented, with 74 issues listed on the NSE, hence there are no benchmark issues and a lack of volume and liquidity for individual issues.

The Capital Markets Authority (CMA) plays a key role in the regulatory structure. It approves all corporate and government bond issues, and also licenses the NSE, the CDS, brokers, financial advisors and fund managers. The CMA is seen as being slow, lacking in capacity, and more regulatory than facilitative, although this is denied by the CMA itself. Credit ratings are required for Asset Backed Securities but not for other corporate bonds. There are also issues of market integrity in the Kenyan capital market, and the recent collapse of two broking firms has undermined trust in the market. The regulatory structure is fragmented, with separate pensions and insurance regulators.

Initiatives under way to develop the bond market include:

- Consolidation of government bonds to establish benchmark issues, and the re-opening of existing bonds at auction;
- Legal reforms;
- Establishing an OTC market for government bonds to enable major institutions to trade amongst themselves and by-pass the NSE;
- Establishing a Primary Dealer system;
- Improving trading & settlement by introducing electronic trading of bonds, establishing linkages between the NSE's ATS, the CDS and the bond CDS at the CBK, thereby removing the need for paper-based trading and settlement; and
- Reviewing the processes for the approval of bond issues by the CMA, and a re-orientation to becoming more facilitative.

A US Treasury Advisor has been seconded to the CBK to assist with government bond market development in Kenya and other countries of the EAC.

In February 2009, the Government issued an "infrastructure bond" through the CBK. The issue was oversubscribed, although the cut-off rate was relatively high, and above the 12.5% coupon rate. Although termed and infrastructure bond, this was mainly a marketing term, as the proceeds are not legally obligated to infrastructure development, the bond is on the Government's balance sheet, and the servicing of the bond will be from general revenues and not from infrastructure investments. Nevertheless, it was viewed as a successful "testing the waters" initiative that will support the issuance of true infrastructure bonds in due course.

The initiative to issue infrastructure bonds is seen along with the issuance of municipal bonds as a promising way to develop the bond market in East Africa. However, municipal bonds should be seen as a very long term project (at least if they do not have central government guarantees), given that municipal finances, accounting and debt service capacity is very limited.

The corporate bond market is undeveloped; there are only 11 bonds in issue, from eight issuers, all of which are floating rate notes because of concern about interest rate risk. There is competition from banks/syndicated loans, which have typically been much cheaper than bond finance (often being offered below T-Bill rates). Bank loans are also seen as being easier and quicker; bond issues are thought to involve lengthy procedures and more transparency, which may not always be welcomed. However, the corporate bond market is considered to hold promise; the poor recent performance of equities has raised interest in bonds, and interest rates on bank loans have been rising. Several companies have indicated to the CMA that they are considering bond issues.

Sources: Standard Chartered Bank; personal interviews with NSE, CMA, CBK and market participants.

Lesotho

Lesotho has Treasury Bills but no government or corporate bonds in issue. However, the Central Bank of Lesotho (CBL) is developing the capacity to handle bonds, and it is anticipated that in due course the Government of Lesotho will issue bonds for capital market development purposes. Initiatives under way include the establishment of a capital markets section in the CBL in January 2009, plans to acquire a CDS for government bonds, the drafting of relevant laws and regulations, consumer education and regular liaison with the Ministry of Finance and major market participants.

Malawi

Type of Bond	No. in issue	Market Cap, Dec-2008 ($mn)	%	Turnover (2008)	Liquidity
Government	1	36	100%	0	0
Corporate	0	0		0	0
Total Bonds	**1**	**36**		0	0

The Malawi bond market is at the very early stages of development. Only one bond has been issued, a 3-year fixed rate bond issued in two tranches by the Reserve Bank of Malawi (RBM) in 2008. It is intended that the bond will be listed on the Malawi Stock Exchange.

The main constraints to developing the bond market include:

- high returns in competing products, especially treasury bills, which would make bond issuance an expensive source of finance, especially if these high rates are locked in for long periods on fixed rate bonds;
- a shallow financial market, with a limited range of financial instruments available in the market;
- a narrow investor base with a small pension fund sector and limited retail demand for bonds at this early stage of market development;
- a lack of financial expertise in the market on bond products; and
- limited financial education and understanding, and low levels of information dissemination to potential investors.

The regulatory structure is limited, with the RBM being the only regulatory authority. Initiatives under way include:

- Developing listing and trading rules for bonds on the Malawi Stock Exchange; and
- Sensitisation workshops with potential Bond Issuers and Market Investment advisors.

General capital market development initiatives, such as strict surveillance of trading and settlement practices to ensure adherence to MSE Member's rules; in-house training with MSE members on dealing ethics, conduct and adherence to the Member's rules, and regional harmonisation of listing requirements with SADC stock exchanges listing requirements. These are primarily focused on the equities market and do not relate specifically to the bond market.

Mauritius

Type of Bond	No. in issue (listed on SEM)	Market Cap, Dec-2008 ($mn)	%	Turnover (2008)	Liquidity
Government	11	3330		n/a	n/a
Corporate	n/a	n/a		n/a	n/a
Total Bonds	**n/a**	**n/a**		n/a	n/a

The Mauritius bond market is dominated by government bonds. The government bond market is reasonably large (48% of GDP). However, not all bonds are listed on the SEM; for instance, 61 government bonds are listed on Bloomberg, with maturities up to 20 years, but only 11 are listed on the SEM. Institutions tend to "buy and hold"; however, no quantitative information is available on trading levels or liquidity.

Trading activity is largely confined to treasury bills and short-maturity bonds. A primary dealer system exists, and a category of "licensed investment dealers" has been established, comprising stockbroking firms.

Although a number of corporate bonds have been issued, the market is not very active in terms of new issues or liquidity.
The main constraints to bond market development include:

- Lack of liquidity and fragmented issues;
- Small market, with too few participants
- Buy and hold strategies by institutional investors
- No benchmark bond issues
- Lack of dealers with experience in trading fixed income instruments
- Lack of capacity to advise investors on investment opportunities and trading techniques
- Uncertainty over monetary policy

A number of initiatives are under way to develop the bond market. A committee comprising representatives of the SEM, the Ministry of Finance and the Bank of Mauritius has been established to review operational issues relating to the bond market. The BoM has taken over debt management functions of the Government, which should further encourage bond market development.

Mozambique

Type of Bond	No. in issue	Market Cap, Dec-2008 ($mn)	%	Turnover (2008)	Liquidity
Government	6	154.1	74%	2.6	1.7%
Corporate	9	54.5	26%	0.7	1.3%
Total Bonds	**15**	**208.6**		3.3	1.6%

The Mozambique bond market is relatively new and small (3% of GDP). Both government and corporate bonds exist and are listed on the Mozambique Stock Exchange (MZE), although government bonds dominate both capitalisation and trading. However, investors tend to buy and hold and liquidity on both types of bonds is extremely low (1.6% in 2008).

The MZE plays a key role in driving the market. It advises the Government (Ministry of Finance) on public debt issues, handles underwriting of bond issues by the banks, and aims to develop public participation in the market.

The bond market faces a number of constraints, including: the low level of bond issues (reflecting government's access to external donor funds for financing budget deficits, at a much lower cost than domestic bond issues); the lack of a public debt issuance programme; the absence of professional brokers/dealers, which undermines the competitiveness of capital markets as alternative source of

financing; and competition from bank loans. Furthermore, although the banks are meant to assist with developing the bond market, they have a conflict of interest as they also wish to make loans to corporates who might consider issuing bonds.

A new Securities Code is being drawn up and is awaiting Government approval, which provides more legislative authority to the Mozambique Stock Exchange. Regulatory requirements encompass small and medium enterprises. The issuance of new bonds is being encouraged by simplified prospectus requirements to stimulate small and medium enterprises; low fees are charged to promote the competitiveness of bond products; and the tax exemption for Treasury Bills has been removed to provide a more level playing field for corporate bonds.

The MZE is also attempting to improve the trading environment. It assists the bonds' sponsors in all procedures for new issues; holds special and public exchange sessions are held for all new issues aimed at public information; works with the central bank on settlements issues; and is developing a website specifically for Primary Issues of Public Debt, interconnecting with the settlement system and providing market information.

Source: Mozambique Stock Exchange (MZE)

Namibia

Bond market capitalisation (end-2008)

Type of Bond	Number of Bonds in Issue	Total Market Capitalisation (N$mn)	% of cap	Total Market Capitalisation (US$mn)
Government	5	5,885	72%	626
Quasi-govt/parastatal	3	1,273	16%	135
Private sector (corporate)	7	1,016	12%	108
TOTAL (All bonds)	**15**	**8,174**	**100%**	**870**

Bond market trading (2008)

Type of Bond	Total value traded (N$mn)	% of turnover	Liquidity
Government	399	74%	6.8%
Quasi-govt/parastatal	132	24%	10.4%
Private sector (corporate)	10	2%	1.0%
TOTAL (All bonds)	**541**	**100%**	**6.6%**

The Namibian bond market is of a similar magnitude to that of Botswana, although relatively more dominated by government and parastatals, with a lower level of

private corporate bond issues. There is also an active money market comprising central bank paper/T-bills. The bond market has only moderate liquidity; relative to demand there is a shortage of assets and the institutions tend to adopt a "buy and hold" strategy.

The Namibian stock exchange lists bonds and acts as a clearing house for information on bond market trades but does not provide the market itself. Listing requirements are the same as those adopted by the Bond Exchange of South Africa.

The main constraints to bond market development are reported as:

- Lack of comprehensive market information, as not all trades are reported to the NSE;
- Inadequate legislation; lack of dedicated legislation for securities markets; prohibition of listing of bonds issued by local authorities;
- the capital market is small with restricted investment opportunities; pension funds are required to keep 35% of their assets invested in Namibian instruments. While this provides a market for bond issuers, the institutions tend to adopt a "buy & hold" strategy;
- Government revenues have been high in recent years (due to high Southern Africa Customs Union - SACU receipts), leading to budget surpluses, thereby limiting the need for government borrowing and bond issue; and
- Capacity in the capital market regulator, NAMFISA, is limited, and regulatory authority is split between NAMFISA and the Bank of Namibia.

Ongoing initiatives to develop the bond market include:

- **Developing the Legal and Regulatory Structure**: the market regulator (NAMFISA) is in the process of introducing legislation based on the Securities Services Act of South Africa; and
- **Regional co-operation/harmonisation/market integration**: The NSE is part of CoSSE, CISNA and the CMA. Listing requirements are harmonised with those of South Africa, to encourage market integration.

Sources: Namibia Stock Exchange (NSE)

Rwanda

Rwanda has an embryonic bond market, with three government bonds and one corporate bond listed on the newly-established Rwanda Stock Exchange. Market capitalisation amounts to only 0.8% of GDP.

Market development (for both equities and bonds) is being driven by the Capital Markets Advisory Council (CMAC), which at present is both the regulator and operator of the market. CMAC works closely with the Central Bank and the Ministry of Finance. It is responsible for:

- Developing guidelines and disclosure requirements
- Approving and admitting issues;

- Developing trading rules and infrastructure;
- Market development;
- Institutional development

The main constraints to bond market development in Rwanda are:

- Few products;
- Lack of institutional capacity;
- Lack of manpower/skills, and need for capacity building;
- Low liquidity;
- Low levels of public awareness (among both potential issuers and investors)

A number of bond market development initiatives are under way. These include:

Developing the Legal and Regulatory Structure;

- **preparing the legal framework for the capital markets, which is at an advanced stage, with draft laws waiting to be tabled to Cabinet and Parliament**
- **establishing an OTC market for trading bonds**
- **developing a Treasury bond Bonds programme**

Encouraging Issuance of New Bonds;

- **planned sensitization program for potential issuers**
- **close collaboration with Central bank and Ministry of Finance on a timetable and predictable of government issuance program for the financial year**
- **working with the Kigali City Council on its first Municipal bond.**

Improving the Trading Environment (e.g. primary dealer system, settlement, market information, credit ratings);

- **Primary dealer system is being considered at the Central Bank**
- **Central Bank working to acquire a CDS system to enable it to automate and dematerialize the process**
- **Primary market and trading activities published on the internet and the media**

Capacity building / training (for regulators, issuers, market participants etc.);

- **Various training programs have been put in place in form of seminars, workshops and attachments to other institutions**

Regional co-operation / harmonisation / market integration; and

- **Regional efforts to harmonize the infrastructure and the laws is underway, the first steps were done by joining the East African Regulatory Authorities (EASRA) and the East African Stock Exchanges Association (EASEA)**

Other

- **Participation in activities of IOSCO and ASEA**
- **Memorandum of agreement with ESMID project under IFC**

Rwanda provides an interesting example of a country that is developing the capital market from the beginning, is making good use of regional collaboration to develop its markets, and is ensuring that the regulatory structure is designed to be consistent with regional harmonisation and integration from the outset.

Seychelles

The Seychelles has a very limited bond market with issues of 3- and 10-year government bonds. There is no stock exchange and the secondary market is believed to be illiquid[4].

South Africa

South Africa has by far the largest and most developed bond market in the SADC – COMESA region. Bond market capitalisation is around US$90 billion, equivalent to some 31% of GDP. The market has a wide range of types of bond in issue, including central and local government bonds, parastatals, and private sector issues from banks and other corporates. There is also a range of securitised instruments and collateralised debt obligations and derivative contracts (swaps, forwards & options). Central government bonds accounted for just over half (53%) of nominal listed value at the end of 2008. However, the market has been changing rapidly, with non-government issues growing fast. For instance, a decade ago (at the end of 1999), central government issues accounted for 82% of total listed value.

Bond Market Trading (2008)

	No. of trades	Nominal (R mn)	Consideration (R mn)	Trades (%)	Nominal (%)	Liquidity (% nominal)
Government	306,298	17,890,380	19,572,813	81.3%	93.0%	4,091
Municipal	1,112	18,325	18,834	0.3%	0.1%	227
State Owned Enterprise	14,268	273,411	255,033	3.8%	1.4%	370
Water Authorities	4,860	162,346	213,865	1.3%	0.8%	873
Banks	18,041	196,843	191,971	4.8%	1.0%	252
Securitisation	4,428	68,833	374,243	1.2%	0.4%	90
Other Corporates	14,330	153,915	149,856	3.8%	0.8%	363
Credit Linked Notes	2,065	24,375	24,566	0.5%	0.1%	103
Commercial Paper	11,340	440,551	433,014	3.0%	2.3%	713
Total	**376,742**	**19,228,979**	**21,234,197**	**100%**	**100%**	**2,344**

Bond Market Capitalisation (end-2008)

	No of	Nominal	Market cap	Market	% of

[4] The Central Bank of the Seychelles did not respond to a request for information for this study

	Listings	listed (Rmn)	(R mn)	cap ($ mn)	market cap
Government	104	437,324	534,558	56,868	57.4%
Municipal	7	8,068	9,127	971	1.0%
State Owned Enterprise	29	73,946	84,576	8,997	9.1%
Water Authorities	11	18,601	24,523	2,609	2.6%
Banks	154	78,187	70,214	7,470	7.5%
Securitisation	315	76,454	79,223	8,428	8.5%
Other Corporates	51	42,455	43,916	4,672	4.7%
Credit Linked Notes	219	23,698	23,708	2,522	2.5%
Commercial Paper	206	61,746	60,894	6,478	6.5%
Total	**1,096**	**820,478**	**930,739**	**99,105**	**100.0%**

However, the most striking characteristic of the South African bond market is its trading volumes and liquidity, and hence the efficiency of price formation. Average daily trade in 2008 was approximately $10 billion. Total market capitalisation of $90 billion supported bond market trade of $2 580 billion in 2008, giving overall market liquidity of well over 2000%. Trading is dominated by Government bonds, which accounted for 93% of trades at nominal value in 2008; liquidity in the government bond market was 4000%. Trading in corporate bonds is much more limited; whereas the Government bond market is very active, corporate bonds tend to be characterised by "buy and hold" strategies. Non-residents are active in the Government bond market.

Bond trading is handled through a specialised exchange, the BESA, which was formed in 1989, and is one of two licensed securities exchanges in South Africa (the other is the JSE, which specialises in equities). BESA entailed the formalisation of the bond market and movement of trades from an informal OTC market to the Exchange. Trading on the Exchange between members enables the elimination or reduction of various risks related to performance, settlement and payment, and delivery. Key roles are played by the clearing house appointed by BESA, the Settlement Agents and the Central Securities Depository. The BESA trading system complies with international (G30) standards.

Key contributors to the development of the South African bond market include:

- The passing of appropriate legislation dedicated to the bond market. Key legislation includes:
    - Banks Act, 1990:
        - Commercial paper regulations;
        - Securitisation schemes regulations; and
        - Exchange control regulations.
    - Bills of Exchange Act, 1964
    - Companies Act, 2007
    - Securities Services Act, 2004
    - Public Finance Management Act, 1999

- Municipal Finance Management Act, 2003
- Collective Investment Schemes Act, 2002
- Financial Advisory and Intermediary Act, 2002
- Long-term Insurance Act, 1998
- Short-term Insurance Act, 1998

- The rationalisation of central government bond issues into a smaller number of benchmark maturities with higher volumes and greater liquidity;
- Regular central government bond issues and a well publicised issuance calendar;
- Openness to foreign investors;
- Continuous enhancement of the availability of market information;
- Ensuring that market infrastructure meets the best global standards; and
- Developing regulations that are not unduly onerous or costly.

The BESA has succeeded in developing an efficient bond market that is significant by global standards. The main constraints faced by the BESA include:

- dealing with the consequences with the proposed takeover of the BESA by the JSE (has not yet received approval from the competition authorities);
- dealing with the impact of volatility in portfolio capital flows from foreign investors, especially given the current global financial and economic turmoil that has resulted in a rise in risk aversion and a need for liquidity in home markets; and
- reluctance by investors to actively trade non-government bonds.

Sources: Bond Exchange of South Africa (BESA); personal interviews

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Swaziland

Swaziland has two government bonds and seven corporate bonds in issue, which are listed on the Swaziland Stock Exchange. Market capitalisation is low (2% of GDP). No information is available on the secondary market, but it is believed to be illiquid[5].

Tanzania

Type of Bond	No. in issue	Market Cap, Dec-2008 ($mn)	%	Turnover (2008)	Liquidity
Government	160	555			
Corporate	6	32			
Total Bonds	**166**	**587**			
T-Bills	Varies				

[5] The Central Bank of Swaziland did not respond to a request for information for this study

Tanzania has a relatively small bond market, dominated by government bonds, which were first issued in 2002. The corporate bond market is relatively undeveloped however, with only 6 in issue.

Government bonds are issued primarily for the purposes of funding the budget deficit. However, government has also attempted to use bonds to develop the capital market. Funding has shifted from initially being based on short-term T-Bills to bond funding. Maturities have been extended to develop the yield curve, and now extend out to 10 years. The BoT acts as agent for the Ministry of Finance in bond issuance. Bond auctions held monthly, and are open to anybody with a minimum bid size of TSh 5 million (approx US$ 4000). The BoT runs the CDS for government bonds, and payment and settlement is automated, through the Tanzania Interbank Settlement System (TISS), a Real-time Gross Settlement (RTGS) system) and the BoT CDS. Early bond issues were oversubscribed but more recent issues were undersubscribed, especially for longer maturities. Foreign investors are not permitted to buy government bonds.

The broader capital market is at the early stages of development. The Dar Stock Exchange has been operating since 1998, and lists 14 equities. The DSE runs a CDS for equities and corporate bonds. There are four pension/provident funds, all statutory. Funds are managed internally, and there is no independent fund/asset management industry. There are few retail investors. Government bonds are listed on DSE and can only be traded through brokers. Secondary market trading for bonds is reported to be virtually non-existent. Most government bonds are held by pension funds on a hold-to-maturity basis.

There are several weaknesses reported in the bond market, including:

- There is no primary dealer system, no market making or two-way quotes (there used to be a PD system but it was suspended following perceptions that it was not working);
- Government bond issues are fragmented, with 160 issues in total, and no re-opening of issues, hence a lack of volume and liquidity for individual issues and a lack of benchmark bonds;
- A lack of bond market specialists, resulting in an inability to price bonds (by banks/brokers);
- A lack of dynamism in the pension fund sector, which is reported to be complacent with regard to investment performance, heavily biased towards property investments and lacking in expertise; and
- The lack of a forum to bring all parties together to discuss bond market development issues.

Regulatory structure: the Capital Market and Securities Authority (CMSA) approves all corporate bond issues and provides umbrella approval for government bonds (it also licenses the DSE and stockbrokers). The CMSA is seen as being slow (6-8 months was quoted as the period needed to scrutinise companies prior to a bond issue), requiring a great deal of information, being more regulatory than facilitative, and lacking capacity. The CMSA focuses on the equity market and retail investors,

and does not have the resources to give the bond market dedicated and specialised attention that is required. The CMSA feels that given the lack of expertise in the fund management/pension fund sector, it has to play a key role in investor protection (even of institutional investors), hence the detailed scrutiny of companies intending to issue bonds.

A number of initiatives are under way to develop the bond market:

- Consolidation of government bonds and the re-opening of existing bonds to establish benchmark issues, reduce the number of bond issues in the market and build liquidity;
- Establishing an OTC market: proposals have been presented for legal/ regulatory changes that would allow the establishment of an OTC market for bonds, which would permit the banks to trade amongst themselves;
- Primary Dealer system: the re-establishment of a PD system is under consideration;
- Trading & settlement: consideration is being given to linking the BoT CDS for government bonds and the DSE CDS for equities;
- Pension fund reform: an Act has been passed to establish a pension & provident fund regulator. It is anticipated that market will become liberalised. The regulator will introduce investment guidelines and licensing for asset managers;
- The CMSA is working on awareness-raising and research on bond market issues;
- Standard Chartered Bank has a workplan to activate secondary trading in the bond market; and
- The US Treasury has placed an advisor at the BoT to facilitate bond market development.

The corporate bond market is almost non-existent; there are only six bonds, all issued by banks. Other potential corporate bond issues face competition from banks/syndicated loans, which are cheaper (interest rates below T-Bill rates) and easier and quicker to secure; bond issues thought to be lengthy and require more transparency. There is little understanding of corporate financing issues, no independent corporate finance advisory capability, and no innovation.

The CMSA requires guarantees from banks for corporate bond issues from unlisted companies. It is concerned about risk and investor protection, and does not believe that pension funds can adequately assess risk (the CMSA is criticised by some parties for being too cautious and focusing on investor protection when in fact most potential investors in bonds are institutions who should be able to look after themselves). Developing corporate bonds will be a long-term process.

Sources: Standard Chartered Bank; personal interviews with the CMSA, DSE and BoT.

Uganda

Type of Bond	No. in issue	Market Cap (end-2008, $mn)	%	Turnover (2008, $mn)	Liquidity
Government	28	717.9	94.4%	214.2	29.8%
Corporate	4	42.9	5.6%		
Total Bonds		**942.7**	100.0%		

The Ugandan bond market has developed steadily in recent years, driven by the government bond issuance programme and the growth of secondary market activity. Government bonds dominate the market, accounting for 95% of total bond market capitalisation; there are only four corporate bonds currently in issue. The market is relatively liquid.

Government bonds are issued primarily for monetary policy and capital market development purposes, but are not used to fund the budget (the government has run a relatively tight fiscal policy, and deficits have been financed from donor funds, which are cheaper than commercial financing). Government has tried to actively develop the bond market and has issued bonds with a range of maturities, up to ten years. The government's bond issuance calendar is published at the beginning of the financial year, with indicative amounts to be issued. Bonds are sold through monthly auctions, and although issues are sometimes cancelled for liquidity reasons, adequate notice is given to the market. A primary dealer system is in place, with six banks as members; PDs, can bid for Treasury Bonds at auction and handle bids from other purchasers, but do not make any profit on those bids.

The domestic investor base is small. The dominant institution is the NSSF. The NSSF is a statutory scheme, based on compulsory contributions from employers. Historically it has had a conservative investment strategy, although it has become more active recently; however, it has become embroiled in corruption scandals that have restricted its activities. The private provident fund sector is small, with only around US$120 million of funds under management.

Foreign investors have been important in the market in recent years, contributing to liquidity. They held approximately one-third of T-bonds; this has also had macroeconomic effects as capital inflows have boosted the exchange rate. However, there was a major exodus of foreign investors in the second half of 2008 (around 50% have exited, contributing to exchange rate weakness) due to liquidity needs in home markets and risk aversion.

The constraints to bond market development include:

- too many government bond issues; while there is some re-opening of issues to build volume, the Bank of Uganda caps the size of individual issues due to concern about rollover risk; hence there are not enough benchmark issues of sufficient size and liquidity in the market;

- the Primary Dealer system: PDs participate in government bond issues, but there are mixed views about the effectiveness of the system; by some accounts the system works well, but others claim that the PDs participate more to keep the BoU satisfied and for marketing purposes than because it is a profitable activity; and
- for corporate bonds, there is little demand due to competition from bank loans which are generally cheaper and easier to obtain compared to the long approval processes for corporate bond issues.

Institutional and Regulatory system: the Bank of Uganda plays a central role in the bond market, determining the auction programme, managing auctions, and appointing PDs. It also handles T-bond CDS and settlement (via the RTGS system), publishes information on all T-bond trades, and plays some market development role. The USE also plays an important role, handling the listing of all government and corporate bonds, and is the clearing house for information on bond sales. It operates a CDS for equities and corporate bonds. The CMA regulates the USE and brokers and determines guidelines and conditions for corporate bond listings. The CMA has to approve all corporate bond issues and issue a “no objection” notice for government bond issues; the process can be slow for corporate issues. The CMA also has public education and market development responsibilities. There is some concern about the capacity of the CMA to handle all of its responsibilities. The lack of a pensions regulator, and lack of clarity as to what parameters will be established for the pensions sector when the regulator is in place, leaves the pensions sector in a legal and operational vacuum.

The legal framework has nothing specific for bonds (e.g. the bond approval process is based on that for equities, even though risk profiles are different) and needs updating. The recent passing of the CDS Act allows electronic settlement.

Several market development initiatives are under way, including:

1. The government is reforming the regulatory framework, including establishing a pensions regulator; however there is concern that there will be to many regulators (with separate regulators for securities markets, insurance and pensions);
2. The Financial Markets Development Programme (FMDP): this is a broad-based financial market development programme taking place over the period 2008-2012. The Vision of the FMDP is to develop “An efficient, broad, deep and vibrant financial market that conforms to international best practices as well as supporting regional development”. The plan has five goals, relating to: (i) deepening and widening of the financial sector; (ii) infrastructure and regulatory development; (iii) regionally integrated financial markets; (iv) a growing investor base; and (v) information and communication. The FMDP is co-ordinated with similar plans throughout the East African Community, and was drawn up following a process agreed upon for all countries by the Monetary Affairs Committee (MAC) of the EAC;

3. Bond Dealers Association: this is being established under the auspices of the BoU;
4. Development /enhancement of the PD system: clarification of rights and responsibilities; ensuring capital adequacy for market making;
5. Extending the range of government bond issues: potentially through the issue of infrastructure bonds and municipal bonds;
6. Market infrastructure: considering a single depository to accommodate equities and T-bonds which would facilitate Delivery versus Payment (DVP);
7. Promotion of corporate bonds: the USE and CMA are attempting to promote corporate bonds, along with the private sector, but take-up is slow; and
8. Regional initiatives: the USE is member of the EASMA; the CMA is member of the EASRA; securities markets rules (regulatory framework and listings rules) have been largely harmonised across the EAC; ESMID has contributed to bond market development through capacity building and analytical work in three areas (i) market infrastructure; (ii) legal framework; and (iii) roadmap for regional integration.

Sources: Standard Chartered Bank; personal interviews with the USE, CMA, BoU and market participants.

Zambia

Type of Bond	No. in issue	Market Cap, Dec-2008 ($mn)	%	Turnover, 2008 ($mn)	Liquidity
Government	212	1722		1.2	0.1%
Corporate	7	268		0.0	0.0%
Total Bonds	**219**	**1991**		1.2	0.1%

The Zambian bond market is moderately large in terms of capitalisation (15% of GDP) and is dominated by government bonds. Most investors buy to hold. However, the market is very illiquid (0.1%), with only six trades taking place in the whole of 2008. The bond market has been active in the past, with 434 trades taking place in 2003. The bond market has been driven by government's funding needs. Government bond issues are handled by the Bank of Zambia and are listed on the Lusaka Stock Exchange (LuSE). Foreign investors are able to participate. A primary dealer system exists. Government bond issues are fragmented, resulting in a lack of benchmark bonds and low liquidity.

Corporate bonds fall under the Securities and Exchange Commission (SEC), which has responsibility for both regulating corporate bond issues and promoting the market. The corporate bond market is underdeveloped due to:

- Competition from bank loans;
- "Crowding out" by government bond issues; and
- Lack of understanding and awareness of corporate financing issues.

The SEC is promoting the corporate bond market through:

- Promoting initiatives under the national FSDP to try and remove impediments to the development of a broad and deep financial sector by removing inconsistencies in the various financial sector pieces of legislation;
- lobbying government to give fiscal incentives to encourage participation in and growth of the bond market; and
- improving market structure and availability of information, i.e. a credit reference bureau was recently established, meetings have been held to reform the primary market dealer system, and undertaking an aggressive market information campaign.

The LuSE has also been holding bond market workshops. More generally, the LuSE is improving the market environment through the introduction of an automated trading system and improving market information.

The LuSE and the SEC have been receiving assistance from the Bond Exchange of South Africa.

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APPENDIX 3: Bond Market Development Initiatives in SADC and COMESA - Strengths, Weaknesses, Opportunities & Threats

INITIATIVE/COUNTRY	STRENGTHS	WEAKNESSES	OPPORTUNITIES	THREATS
ANGOLA				
Establishment of capital market institutions (Capital Markets Commission, Stock Exchange, Training Institute) and legal structure.	Ongoing. Capital Markets Act passed (2006). CMC up and running. Stock Exchange due 2009 with ATS.	Lack of financial instruments; limited experience in issuing or trading; small investor base; macroeconomic distortions	Contribute to development of market-based financial system, complementing other initiatives	Uncertainty over supply and demand for securities. Highly controlled economy/limited markets. Plans may be over-ambitious, expensive and threatened by lack of resources if oil prices remain low
BOTSWANA				
Developing government bond market, yield curve & liquidity	Yield curve exists, based on risk-free government bonds. Has stimulated issue of corporate & other bonds, which account for majority of bond market capitalisation. MFDP and BoB active in bond market development.	Low liquidity for govt. and especially corporate bonds; concerns about effectiveness of PDs; lack of supply of govt bonds and infrequent issues; buy-and-hold by investors; yield curve inverted so short-term instruments have higher yields	Adverse fiscal developments likely to stimulate new bond issues, which will improve supply-demand balance and boost liquidity. Combined with falling inflation, should flatten yield curve.	Adverse macroeconomic and fiscal developments likely to cause instability.

Credit ratings	Sovereign has had investment grade rating since 2001, highest in Africa	Lack of interest/high cost of corporate credit ratings, leading to lack of information on which to base risk-premia; no local ratings agency or Botswana-specific ratings scale	Initiatives to build awareness of role of credit ratings; strategic alliances with ratings agencies/other markets	Adverse macroeconomic and fiscal developments may lead to sovereign rating downgrade
Market infrastructure and legislation	Steady flow of corporate bond issues despite lack dedicated legislation. Investment in ITR systems ongoing: CSD & ATS	Need for dedicated bond market legislation, especially for securitised instruments, and improvements in listing rules. Slow approval processes for bond issues, long settlement cycle	CSD and ATS can incorporate corporate bonds. New securities legislation being prepared.	Slow pace of change; dependence on government for resources; non-bank regulator (NBFIRA) only just established and has limited capacity.
Developing market awareness and understanding	Improvements since 2003. A Bond Market Task Force has been established, including al market participants.	Limited understanding of bond market issues amongst brokers and wider financial community	BSE active in awareness-raising (bond market and credit rating seminars held in 2008)	Lack of resources at BSE and NBIFIRA for bond market development.
KENYA				
Boosting market liquidity	Good liquidity by SSA standards	Fragmented government bond issues, no benchmarks	Establishment of PD system should help market-making. Consolidation of govt. bond issues and establishing OTC market should boost liquidity. Technical support	PD systems difficult to get working effectively in small markets – incentives are crucial. Can be slow process to consolidate bonds if

			from US Treasury Advisor.	done through re-opening.
Market infrastructure, information and legislation	All bonds listed on NSE. Corporate bonds included in the NSE's ATS	No PD system; govt. bond trading still paper-based and lengthy; some lack of transparency; concerns about market integrity	Introducing electronic trading of govt bonds, linking of ATS and CDSs at NSE and CBK should speed up trading.	
MALAWI				
Establishing bond market	First govt bond (reserve bank) issued in 2008. Stock exchange exists.	Starting from scratch. No corporate bonds	Can learn from other countries' experiences.	Lack of awareness, cost of market and regulatory infrastructure in small, poor country
MAURITIUS				
Developing bond market	Well developed stock market, good infrastructure, range of government bonds in issue	Many bonds not listed on SEM, low liquidity, focus on T-Bills and short-term bonds; buy and hold by investors; virtually no corporate bonds	New initiative under way to develop bond market by SEM, central bank and Ministry of Finance	Lack of technical capacity in bond market, long process of awareness-raising and capacity-building.
MOZAMBIQUE				
Establishing bond market	Several govt and corporate bonds in issue. New and active stock exchange (MZE)	MZE handles all responsibilities. Govt access to donor funds. Competition from bank loans.	Legal and regulatory reforms under way, simplified processes to boost market and assist SME involvement.	Lack of awareness, cost of market and regulatory infrastructure in small, poor country

NAMIBIA				
Improving liquidity in government bond market		Fiscal surpluses, shortage of bonds, buy-and-hold strategies by investors	Declining SACU receipts may lead to budget deficits and more govt bond issues	Macroeconomic weakness due to global crisis
Legal and regulatory reform	Common listing requirements with South Africa (BESA)	Outdated legislation	Regulator introducing new legislation, based on South Africa	Lack of capacity at regulator
RWANDA				
Establishing bond market (and capital market more generally)	No historical legacy of systems and institutions; determination to modernise financial system, high level support	Market very small and underdeveloped	Opportunity to learn from regional partners and experience; build in capability for regional market integration and harmonisation from the beginning; comprehensive development programme in place	Lack of capacity, resources, awareness
SOUTH AFRICA				
Maintaining international investor interest; keeping bond market up to date in terms of international developments and standards	Large, highly liquid bond market meeting world-class standards. Dedicated bond exchange. Regular government bond issues, benchmark bonds.	Volatility in foreign portfolio investment flows. Low liquidity in non-government bonds.	Continuous review and reform of market infrastructure and regulatory regime	Possible takeover by JSE
TANZANIA				
Boosting market liquidity		Fragmented government	Establishment of PD system	PD systems difficult to

		bond issues, no benchmarks. Availability of donor funds to finance deficit. Foreign participation not permitted. Few corporate bonds. Virtually no bond trading.	should help market-making. Consolidation of govt. bond issues and establishing OTC market should boost liquidity. Technical support from US Treasury Advisor.	get working effectively in small markets – incentives are crucial. Can be slow process to consolidate bonds if done through re-opening.
Regulatory reform and liberalisation of pension sector	Ongoing; Act has been passed	No pensions regulator or legal framework for pensions sector; private pension funds & asset management sector non-existent. Pension sector dominated by statutory funds.	Clarify legal framework for pensions, set standards, establish regulator; liberalised pensions sector can be a driving force for bond market development, would encourage private asset management sector	Lack of capacity of new regulatory; regulatory fragmentation (securities markets, insurance, pensions) with high costs; delays
Market infrastructure	Automated government securities system at BoT	No PD system. CMSA perceived as slow in approving bond issues.	Consideration being given to re-introducing PD system, OTC market, and linking CDSs at BoT and DSE. CMSA reviewing procedures.	Lack of resources/capacity
Awareness-raising		Little awareness of bond markets, little capacity in market, firms unsophisticated, no independent financial advisors	CMSA engaging in awareness-raising programme. Standard Chartered Bank active in market development.	Slow process.

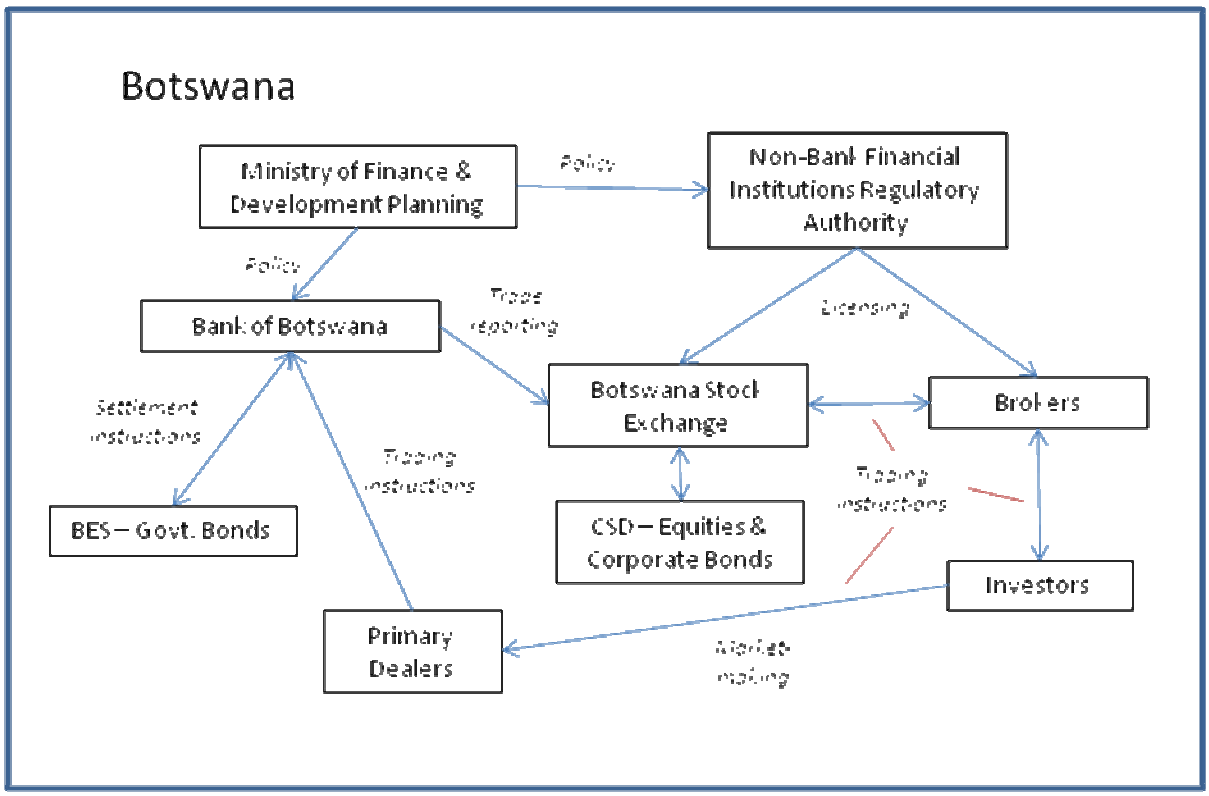
UGANDA				
Financial Market Development Programme	Led by BoU, strong commitment, backed by MFPED. Funding from World Bank for years 1 & 2. Coherent overall plan, regionally co-ordinated.		Development of broad, efficient and liquid financial markets across a range of instruments; improved investor base; improved information; improved regulatory framework; regional integration	Ambitious programme, requires buy-in and action from range of participants; may be difficult to secure funding for infrastructure needs; delays
Primary dealer system	PD system in operation since 2005. Generally seen as working well.	PDs claim little direct benefit of participation Only 3 PDs trade for own account	Development of Bond Dealers Association; Review of PD rights and obligations	Lack of capital for market making; lack of skills/capacity
Regulatory reform and liberalisation of pension sector	Ongoing; Bill has been prepared	No pensions regulator or legal framework for pensions sector; private pension funds are small, with little cash to invest; "Buy & Hold", little secondary market trading Pension sector dominated by statutory NSSF; corruption scandal at NSSF has led to pullback from market	Clarify legal framework for pensions, set standards, establish regulator; establishment of funded government pension scheme; liberalised pensions sector can be a driving force for bond market development, would encourage private asset management sector	Lack of capacity of new regulatory; regulatory fragmentation (securities markets, insurance, pensions) with high costs; delays
Market infrastructure & transparency	Same day value & settlement for govt	All trades OTC, hence counterparty risk.	Combine USE CDS for equities with BoU CDS for	Small market makes infrastructure

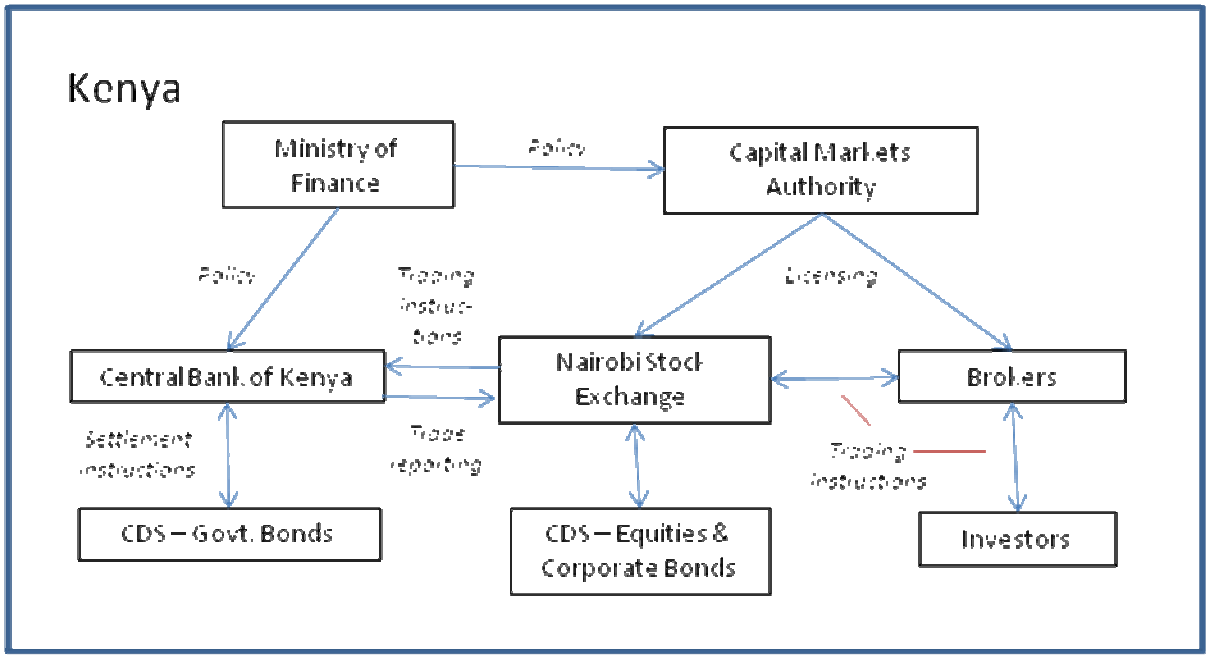
	bonds; listed on USE; trades published by BoU		government bonds	investments expensive
Government debt management	Bonds introduced to provide benchmark yield curve & develop capital market; Issuance programme available in advance; Good notice if issues cancelled; active foreign participation; increasing secondary market activity	Concern about fragmented issues and lack of scale/ liquidity. No need for government to fund spending from bond issues; Availability of donor funds	Adverse environment for donor funds may put pressure on government to fund deficits domestically Potential for municipal authorities to issue debt and for infrastructure bonds	High risk municipal borrowers (financial systems undeveloped); Reduced interest from foreign investors due to credit crunch and risk aversion
Education/awareness	Private sector and BoU active in capacity development	Stockbroking firms have limited capacity to price corporate issues correctly		Slow process, lack of resources.
Corporate bonds		Numbers still small; Pricing does not favour bond issues	Improve pricing on loans to properly reflect risks (and hence encourage bond issues)	Competition from syndicated bank loans; some potential issuers avoid greater transparency of bond issue
ZAMBIA				
Capital market development	Financial Sector Development Plan (FSDP) envisages broader and deeper capital market – widely supported		Review of legislation will provide opportunities to remove impediments to capital market development	Lack of resources

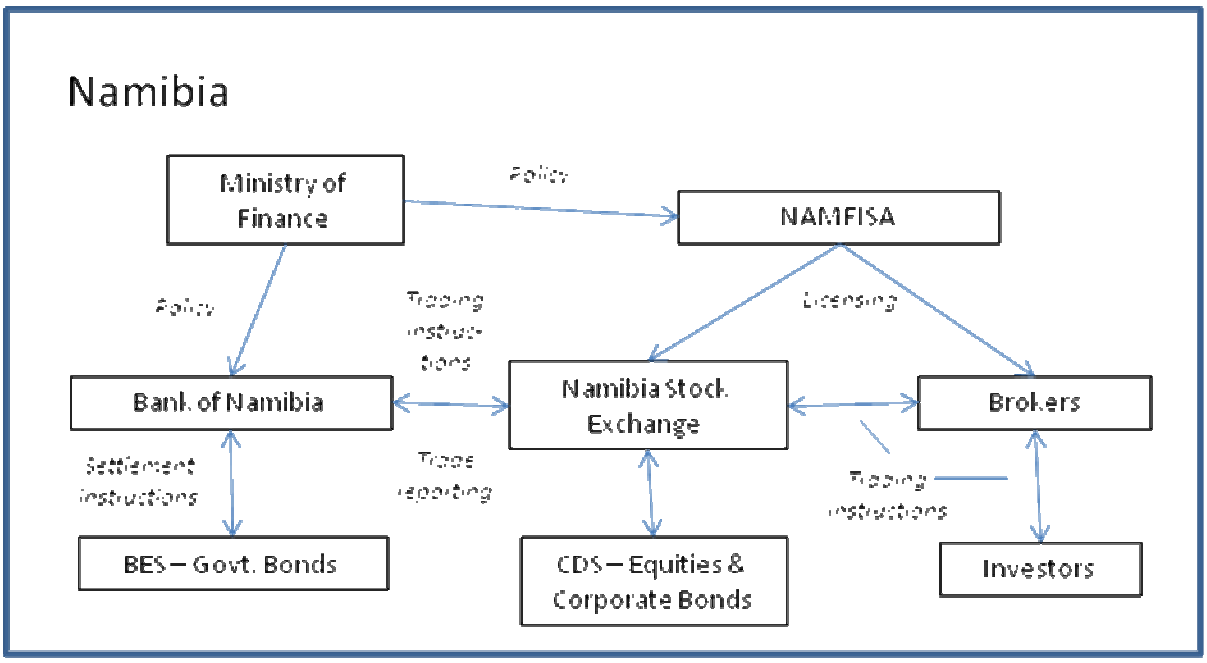
Developing bond market liquidity		Liquidity has declined in recent years; now virtually no trading. Govt bond issues are fragmented.	Reform of PD system to make more effective	
Promoting corporate bonds		Corporate bond market virtually non-existent	Awareness-raising campaign under way. LuSE and SEC receiving assistance from BESA.	
REGIONAL INITIATIVES				
ESMID	Well structured, focusing on regulatory reform, improving market infrastructure, capacity building, regionalisation, and promoting replicable transactions	Pilot project only; has not yet had formal review	Initial results suggest delivery well-targeted interventions in a cost-effective manner, promoting regional integration and economies of scale. Potentially replicable elsewhere.	Dependent on donor support; future uncertain.
EASRA and EASMA (East Africa)	Aiming to harmonise legal and regulatory frameworks; introduce cross-border listings; linking of regional stock exchanges	Time consuming (travel /meetings)	Regional economies of scale; higher international profile; deeper and more efficient market	Can be unwieldy; restricted to speed of slowest participant; highly politicised; potential complications of COMESA/SADC memberships
EAC MAC	Regional central banks collaborating on securities market development	Time consuming (travel /meetings)	Co-ordination of activities in national markets; co-ordinated reforms	Can be unwieldy; restricted to speed of slowest participant;

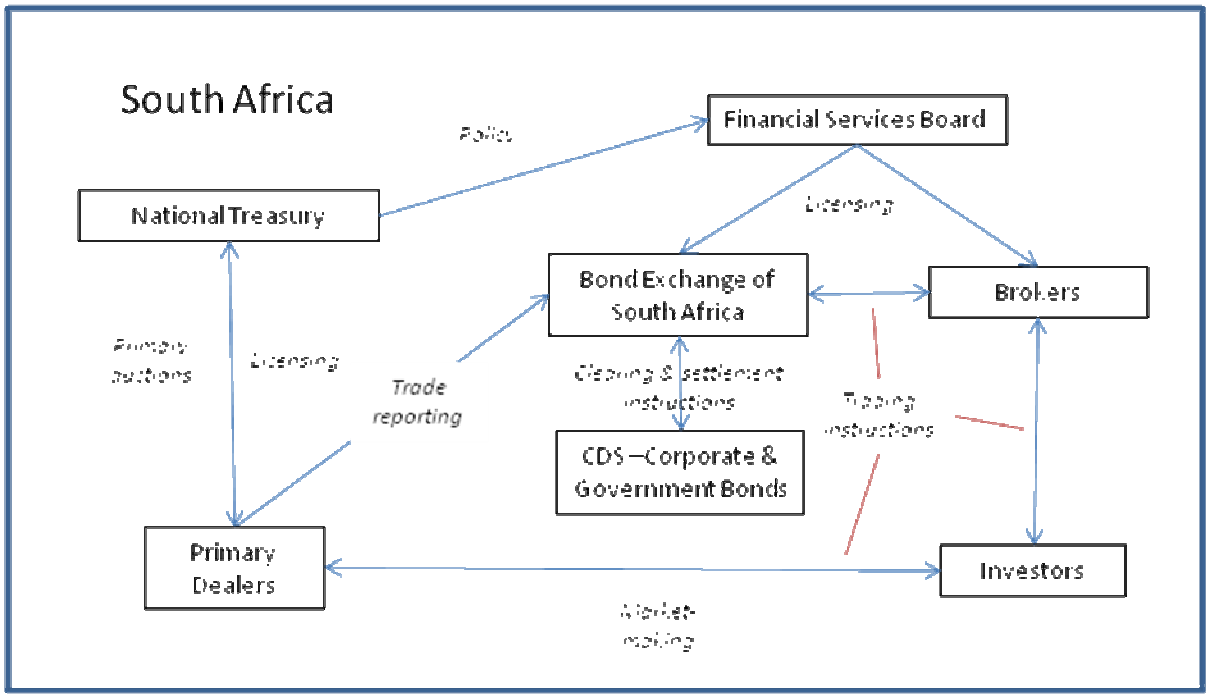
				highly politicised; potential complications of COMESA/SADC memberships
COSSE (SADC)	Harmonisation of listing requirements; linking of regional stock exchanges	Main priority is equity markets; bond markets not a priority	Support available from BESA.	Lack of resources at both regional and national level.
CISNA (SADC)	Aiming to harmonise legal and regulatory frameworks	Responsibilities are broad (pensions, insurance, securities)	Can eventually contribute to regional market harmonisation and integration	Lack of resources at both regional and national level. Legal reforms at national level can be very slow.
CCBG CMDP (SADC)	Regional central banks collaborating on securities market development	Commencing 2009. Workplan and priorities still to be developed.	Weaker members can be assisted by experiences of stronger/more advanced members	
Common Monetary Agreement (CMA)	Quasi-monetary union in South Africa, Lesotho, Namibia, Swaziland; regionally integrated capital market	SA has dominant position	Contributes to macroeconomic stability in LNS.	Concern about outflow of capital to SA from LNS.

APPENDIX 4: Mapping of Bond Market Institutions – Selected SADC and COMESA Countries

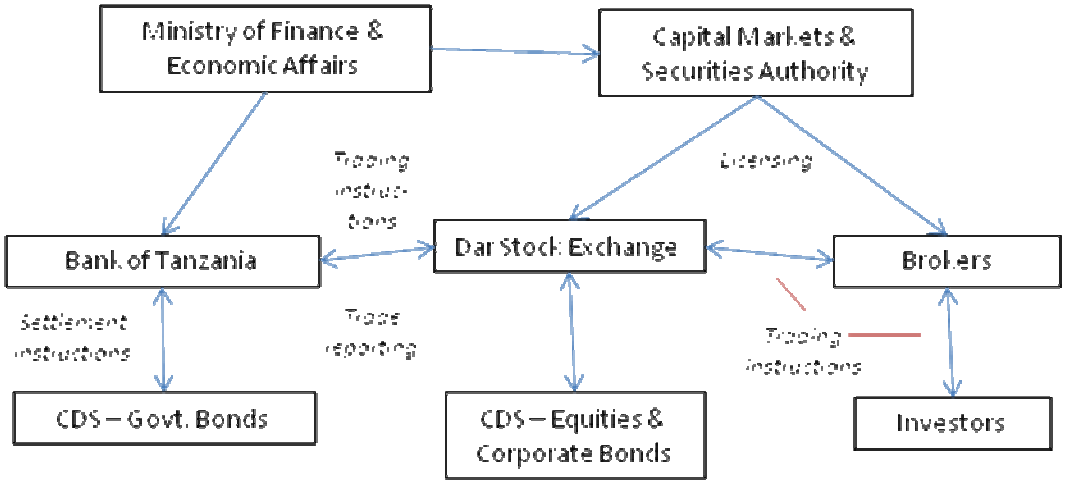




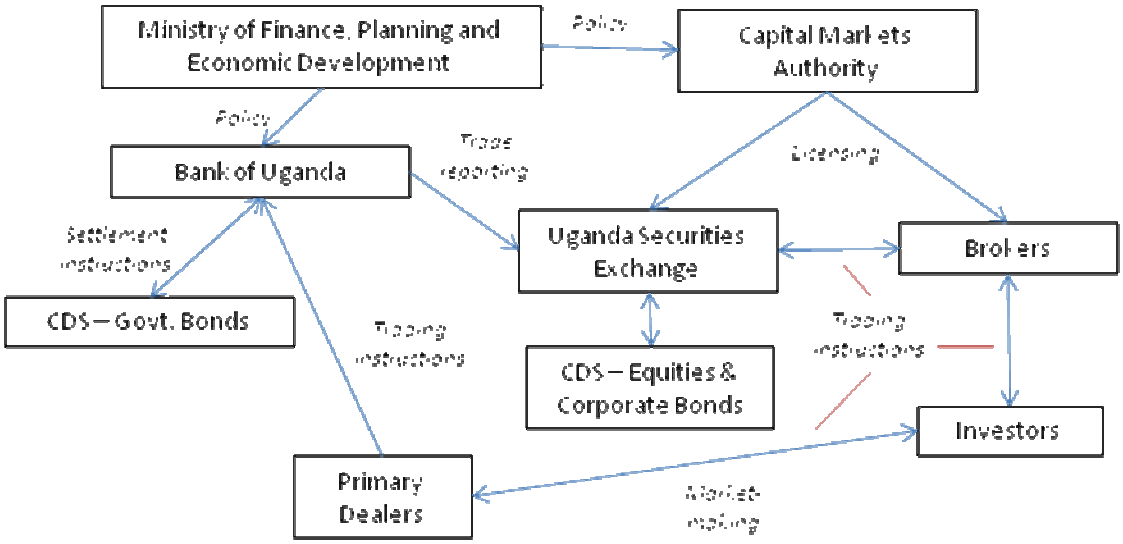

Namibia
Ministry of Finance
Policy
NAMFISA
Policy
Trading instructions
Licensing
Bank of Namibia
Namibia Stock Exchange
Brokers
Settlement instructions
Trade reporting
Trading instructions
BES – Govt. Bonds
CDS – Equities & Corporate Bonds
Investors


South Africa
Policy
Financial Services Board
National Treasury
Licensing
Bond Exchange of South Africa
Brokers
Primary auctions
Licensing
Trade reporting
Clearing & settlement instructions
Trading instructions
CDS – Corporate & Government Bonds
Primary Dealers
Investors
Market-making

Tanzania



Uganda



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