

# NOTHING VENTURED, NOTHING GAINED:

## Regulatory Reform and Achievements in Egypt's Capital Markets

Founder and Managing Partner of Sarie Eldin & Partners – Legal Advisors, Hani Sarie-Eldin is renowned as both a lawyer and writer for his expertise in economic development. Here he talks to Law Today about Egypt's legal and regulatory frameworks and their impact upon the country's capital markets and economic growth, as well as ways in which the complex process of reform needs to continue.

**LT: How would you characterise Egypt's current capital markets and broader corporate finance climate, within the broader regional context?**

**HS:** Egypt's capital markets have been developing very well in the last few years when it comes to important determining factors, including the regulatory framework, legal framework, transparency and disclosure requirements. They are quite mature. In terms of the companies listed, and the transactions that have taken place, these have definitely been affected negatively in the last few years by the economic crisis and the political crisis that started in 2011. However the market is picking up and we saw that clearly last year; there is definitely potential for significant growth and a diversification in the market.

The real challenge as I see it – and this has always been the case – is that the market is still shallow. This means it is easily affected by shocks, and still the number of listed companies is quite low in relation to the economic scale of the country. I think this is very important and that the latest commitment by the government to put more public companies on the stock exchange is a good move, though I do think the number announced by the government for this year is rather optimistic. It will be difficult to achieve this. I think they mentioned their intention of between 14 and 19 companies being listed this year. We are already over halfway through the year, so I don't think this will be achieved. However, it is still a good step forward and will serve for the benefit of the market. I also believe that the market will pick up; we have started to see more acquisition activities and I think the fair prices are quite attractive. So I am quite optimistic for 2019.

**LT: You talked about the market being shallow. Could you expand on this statement?**

**HS:** Yes; when I use the term shallow, I refer to the volume of trading. It has of course improved: in the last few years it has been around 300-400 million EGP per day. Being shallow means that small transactions related to small companies could potentially affect the whole market because the volume of trading is not that big. This is a challenge and it is the reason we introduced certain processes, such as reducing the settlement system from three days to two days. We introduced same day trading and personally I think it's time to introduce short selling. This is all part of a push to introduce more types of securities, to increase the liquidity of the market, add more stability and ultimately to make it more resilient to shocks.

**LT: How would you characterise Egypt's capital markets within the regional context?**

**HS:** I would comfortably put the regulatory environment in Egypt as number one in the Arab Middle East for the time being. Probably it is not the best performing market but it is number one in terms of the quality of the regulatory framework. There are still a lot of things that need to be done, but a lot of work has been undertaken in this area over the last fifteen years and this is why I would put it as number one in the region

for now. The DIFC has of course achieved good results, being purely structured as an international market, but I'm comparing Egypt to the other local markets.

**LT: This reform process has been going on for fifteen years?**

**HS:** It has been a long-term process. Here I'm really talking about the regulatory framework for capital markets.

**LT: What vision has driven that? How has it been able to take shape?**

**HS:** When the economic reforms started in 2003, capital markets were a pillar of that reform plan for different reasons. It was a means of improving national savings around the country; it was used as a tool to spur direct investment (not only portfolio investments) by listing new companies, using tender offers and listing more public sector companies. For all those reasons, capital markets have been an important part of the focus of economic reform in Egypt, which really started in 2003 and lasted until 2009/2010. After the Revolution, the need to continue the process of reform was very clear, in the interest of continued (and continually increasing) transparency and to protect the companies listed, so there has been a continuous reform plan right up to this moment.

Though collectively we address a lot of criticism towards the government, it has to be acknowledged that on this point we really have achieved something. And by, to a degree, deregulating the Financial Services Authority recently, the government has enabled it to enjoy more independence than ever before.

**LT: Could you talk us through the recent amendments to the Capital Markets law of March 2018 and what their impact will be in concrete terms for financial institutions, businesses and individuals operating in the country?**

**HS:** In recent times, there have been changes to the regulatory framework almost every month. Probably the changes you are referring to are related to bonds, which I was not very enthusiastic about. When it comes to bonds in the market in particular, I don't think the core determiners of their efficacy relate to the regulatory framework; rather they relate to the readiness of the market and its structure. I don't think the Egyptian market is ready for bonds, for structural reasons.

I also feel strongly that we missed the opportunity to introduce more comprehensive changes to the Capital Markets law. We should have done that because a lot of the provisions of the Capital Markets law are, I believe, out of date.

We need a new law on all areas related to capital markets: acquisition rules, movable securities, the regulation of the activities being undertaken, the private equity funds framework; none of these are suitable for investment in Egypt and do not reflect best practice worldwide. There are a lot of areas that need to be looked at.





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**LT:** You have held senior advisory positions in some of the country's key financial regulatory institutions, including the Egyptian Market Authority, the Central Bank of Egypt and GAFI. What steps do you think these entities – and those that work with them – should be taking, beyond what they are currently doing, to encourage a thriving economy? Are there ways they could be working more effectively together or with other institutions?

**HS:** My main view on this point is related to GAFI. We do have a good law and good intentions, yet the reality on the ground is still not what it should be and this is particularly what we need to work on further.

GAFI actually has two main functions. One is being a promoter of investment, and I think so far the Ministry of Investment is doing that well and taking everything in the right direction. However, GAFI also acts as a regulatory authority and I think this is where the problems lie. We still have a lot of issues in the bottleneck that need to be solved; bureaucracy is still there and the process and interactions with different authorities are not as effective as they could be. This affects – both directly and indirectly – the promotion of investment, in a negative way.

There is a lot of focus on investment promotion and on improving certain services, a lot of focus on improving the quality of law and provisions related to the protection of investments, but there is little on focus on

solving bureaucracy within GAFI itself and in relation to other concerned parties. There has been some improvement on certain issues, such as the allocation of land. But when it comes to day-to-day issues, such as the increase of capital, approval of board meetings, approval of shareholders' meetings and licensing, for instance, we still need a lot of work to be done on these areas.

**LT:** How does an institution like GAFI go about making the changes you talk about? It seems to me that often there are changes made from a conceptual point of view at the highest level, but then these changes need to be implemented throughout the organisation and that in many ways it's a question of communication, behaviour change or providing sufficient training. In your view, how does one go about addressing the need for change?

**HS:** I think your question had the answers in it; all the elements or factors you mentioned are key. You need to change the culture, the attitudes. You need also to give more flexibility within the approval process to apply the spirit of the law in many different areas, to reduce intervention on the part of the authority, to move to the concept of post-supervisory rather than pre-supervisory in many areas, to move towards a risk reduction attitude as opposed to a compliance supervision attitude. This all needs a lot of training to get things moving in the right direction – and other countries have succeeded in doing this.

**LT:** How can international commercial banks or other financial or investment institutions best navigate, grow in or contribute to an environment where government oversight is still a predominant factor determining growth? Is it even desirable for them to do so?

**HS:** To be honest, if you look at the mapping of commercial banks in Egypt, 70% of them are internationally based and actually this has been a fundamental element of the good reform that took place in the banking sector in Egypt in 2003. Prior to 2003, the Egyptian banking sector was almost bankrupt. One of the main pillars or rationales in resuscitating this ailing sector was to bring international banks to the Egyptian market – and it was a clear part of the philosophy that the ownership of Egyptian banks should belong to financial institutions, reflecting international best practice.

So the Central Bank of Egypt opened acquisition opportunities and this was followed by an unprecedented number of acquisitions in the banking sector throughout the entire region. We have seen international and regional banks coming to Egypt, and priority has always been given to the best banks.

This has meant that Egyptian banks have managed to capitalise on this and to institutionalise quickly. In 2008 Egypt was in fact named number two after Singapore in terms of the solidity of its banking system. I believe this is largely due to the reform process that took place in 2003 and the strategy of bringing international banks to the sector. In spite of what we have gone through in the last ten years, the banking sector is still holding very strong.

**LT:** How would you like to see it keep developing?

**HS:** We need to see more lending to be extended to SMEs; this is very important to the economy. There are good intentions from the Central Bank of Egypt in this regard, however the regulatory environment itself doesn't help commercial banks to enter this area aggressively, at least not to the extent it should. The registration process for SMEs, the licensing and lending rules all need to be looked at as part of the entire strategy. This process does not apply to banks; it is much wider than banks, so you need to reform the whole regulatory environment to ease business for SMEs – not only from the lending perspective.

**LT:** When it comes to the region's corporate finance climate, are there countries that you feel are doing a particularly good job of stimulating growth and creating an environment where healthy competition boosts opportunities and fiscal growth? How could countries within the region learn from one another in this regard?

**HS:** Definitely it would be wrong to have ready-made

laws or regulations that are just applied from one country to another. But still, learning from the experience or expertise of other countries would be helpful. When it comes to banking reform, I think Egypt has done well so far. Even if you look at the Central Bank's approach to assisting banks that were bankrupt – acquiring them, reforming them and then putting them up for sale – this was very effective, and it is what the US and certain other countries did after 2008 also.

In the area of SMEs we still have a lot to learn and improve upon. It goes well beyond banking regulation and has much more to do with investment reform or reforming the environment to facilitate business for these particular SMEs. There is a lot to learn from other countries – I'm thinking particularly of Brazil, Mexico, Malaysia and Hong Kong – in that regard.

Also, we need to remember that there is no shame in learning from other African countries. On the contrary. I think the Kenyan expertise, especially with mobile banking, is something very interesting that we should study and learn from. I believe it would fit with the Egyptian context, applying just as much to those living in Upper Egypt and in the countryside as it would to those living in large cities. This is something very important to look at.

**LT:** You previously held the position of Group Director & General Counsel within the Al Futtain group. I'm very interested in the relationship between the growth of the real estate and construction industries and that of the financial services sector, thinking particularly about how this applies to mortgage financing. How can this relationship be strengthened and maintained? What is its impact on both sectors?

**HS:** The short answer is that mortgage financing really needs a lot of work; it is not as developed as it could be. The structural financing of the real estate industry needs to be looked at. Definitely helping to finance real estate projects by reducing the interest rate for projects directed to classes C and D is very important, yet we haven't seen that happening. Most real estate financing has gone towards class A projects. One of the most problematic aspects of this is that at a certain point there will be saturation in the market, and I think we are already reaching this stage.

It is important to direct financing to class C and D projects but definitely with interest rates being at their current level this won't happen. So something needs to be looked at and changed in this area. There could be a sovereign fund established by the major players, certain taxes could be levied on these projects and the money directed towards such a fund, to help in reducing interest rates on these projects. Something needs to be looked at somehow, probably by the Central Bank and the Ministry of Housing, in collaboration with other major players.