UNDERSTANDING AFRICAN CAPITAL MARKETS

CAMEROON, DRC, LIBERIA AND SIERRA LEONE

ALCB FUND
African Local Currency Bond Fund

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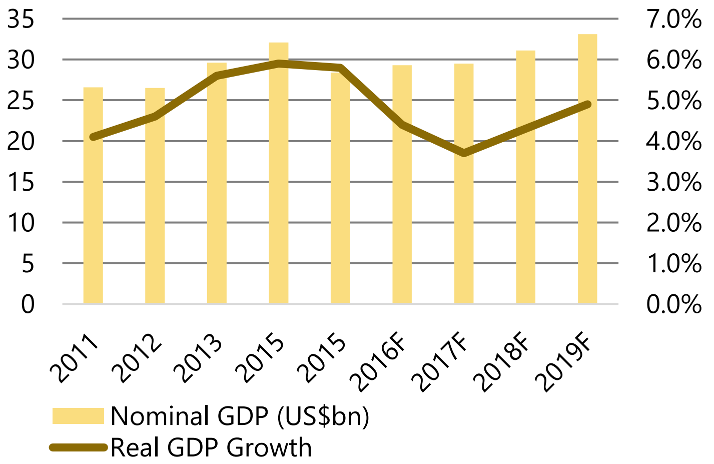
CAMEROON

1. THE MACRO ENVIRONMENT

1.1. Economic Overview

Cameroon's Economy, with an estimated size of 29.5 billion dollars in 2017, is largely driven by agriculture as the primary sector (21.3% of GDP), a robust secondary sector which includes oil production and refining, food processing and the making of light consumer goods like textiles (30.8% of GDP), and a tertiary sector which includes the retail, tourism and hospitality industries (47.9% of GDP).

Fig 1: **Nominal GDP and GDP growth rates**

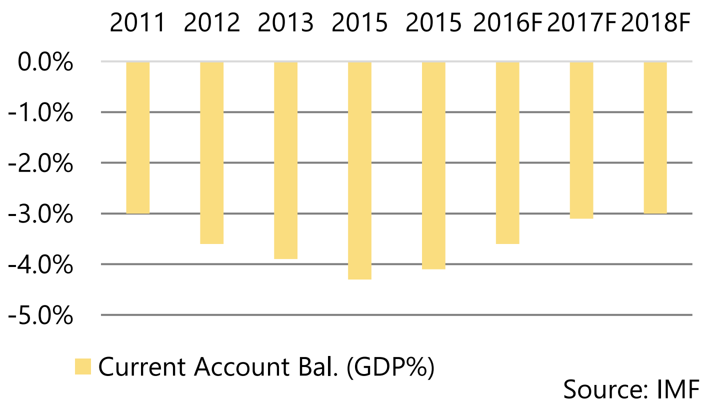


Source: IMF

Crude oil – which accounted for 45% of the country's exports in 2016 – is the largest export commodity in Cameroon. Cameroon is the sixth-largest crude oil producer in Sub-Saharan Africa. A slump in oil prices in 2015 and 2016 limited the growth of Cameroon's economy, and its effects are expected to subdue the economy's growth over the next three years to 2019. Cocoa is the main agricultural export commodity in Cameroon, and the country is the world's fifth-largest producer of Cocoa after Ivory Coast, Ghana, Indonesia and Nigeria.

Despite being rich in commodities, the country is still largely dependent on imports because of an underdeveloped manufacturing sector. Thus, the country has consistently recorded current account deficits since 2011. However, the outlook on this remains positive: Cameroon signed an **Economic Partnership Agreement (EPA)** with the European Union in 2016, that will gradually give Cameroonian exports duty- and quota-free access to the European market. It is expected that Cameroon will gradually open its market to European exports over a transitional period, set to run until 2023.

Fig 2: **Current account balance (GDP %)**



Source: IMF

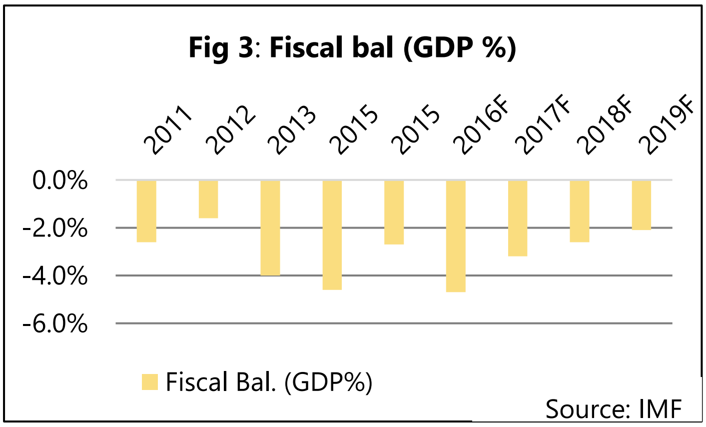
1.2. Monetary Policy

Cameroon is a member of the CFA franc zone – which is composed of two separate and independent unions: the West African Economic and Monetary Union and the **Central Africa Economic and Monetary Community (CEMAC)**.

The CFA Franc, which is pegged to the Euro, has remained stable over the recent past, with the exception of 2017 when debates on devaluation speculations had **a significant impact on swap rates: the 3-years**

EUR/CFA swap rate reached 7% at the end of March 2017 whereas it was only 3% at the end of 2016. This made it more expensive for Cameroonian corporates to refinance internationally**.**

1.3. Fiscal Policy



Cameroon's fiscal deficit was projected to narrow in 2017 as revenues from oil exports are expected to pick up. The IMF forecasts the fiscal deficit to narrow to 2.6% of GDP in 2018 from the estimated 2016 deficit of 4.7% of GDP. The outlook for revenues is bright due to the gas production coming on-stream in 2018. The country also has one of the lowest level of public debt to GDP in Africa, at a public debt to GDP ratio of 31.1% in 2016.

2. FINANCIAL SECTOR

2.1. Banks

There are 14 banks in Cameroon, mostly owned by foreign investors. As of June 2017, the total loan portfolio of Cameroonian banks amounted to CFA 3.0 trillion (USD 5.5 billion) and total deposits were CFA 3.4 trillion (USD 6.2 billion), i.e. a deposit to loan ratio of 1.05[1]. Liquidity ratios stood at 17.5% as of June 2017, compared to a level of 24.4% in June 2016. [2]

Financial intermediation in Cameroon is inefficient: banks buy large quantities of T-bills of the various States of the CEMAC region, which limits the amount of funds available to private sector borrowers looking to access capital from the banks, further highlighting the need for developing a sound local capital market to channel medium to long term resources to corporates and large SMEs. In addition, commercial banks finance their medium-term assets with short term liabilities which increases their risk.

A functional local financial market would therefore present an opportunity for banks to raise long-term funding to on-lend to local corporates and SMEs, and for corporates to have access to long term funding currently not available from local banks.

2.2. Insurance Companies

There are 29 Insurance companies in Cameroon, comprised of 14 general insurers, 10 life insurance companies and 4 re-insurers. Cameroon's insurance sector is the second largest in the region, after Ivory Coast. Insurance firms in the region (including Cameroon) are regulated by the Conférence Interafricaine des Marchés d'Assurance (CIMA), a pan African organization overseeing insurance activities of fourteen Francophone markets in Sub-Saharan Africa.

According to the **CIMA code**, at least 50% of the premiums need to be invested in the country in which they are collected and the other 50% within the member states of CIMA. However, limited availability of diverse financial instruments in Cameroon's underdeveloped capital markets is a bottleneck to insurance companies

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[1] Deposits include regulatory reserves to the Central Bank.
[2] Liquidity ratio is defined as liquid assets over total deposits.

in their efforts to comply with the provisions under the CIMA code; most insurance companies maximize their holdings in liquid assets (short term deposits in banks and MFIs) and mortgages and loans to other financial institutions, as their options are limited. **This highlights the need for development of the capital markets to make available a more diverse range of financial instruments that insurance companies can invest in.**

2.3. Others

Other financial institutions include finance companies and microfinance institutions, which could also be considered as potential bond issuers. There is one public pension fund in Cameroon – CNPS – and no private pension funds. There are no existing asset managers in the country.

3. LEGAL AND REGULATORY FRAMEWORK

OHADA Treaty: Cameroon is part of the list of 17 African countries which ratified the OHADA Treaty, which translates into English as "Organisation for the Harmonization of Business Law in Africa". The OHADA Treaty primes over national legislations.

Oversight: Cameroon's economic and monetary policy maker is the regional central bank **(BEAC**). There are two regulatory authorities in Cameroon:

- **Commission des marches financiers (CMF):** the regulator of financial markets in Cameroon, vetting both public and private issuances, as well as regulating and supervising the activities of brokerage firms (PSI); and
- **Commission bancaire de l'Afrique Centrale (COBAC):** The regulatory and supervisory body of financial intermediaries (i.e. banks and MFIs) in the CEMAC region.

Private Placements: Capital markets activities in OHADA are regulated by **Title 4 (Uniform Act on Commercial Companies and Groups of Economic Interest).** According to OHADA, private placements are allowed if corporate bonds are offered to institutional investors and to less than 100 individuals.

Public Offerings: The issuer is required to prepare a "prospectus" which will shall contain all necessary information on the company and the transaction. **The regulator has a maximum of 30 days to approve the prospectus**. Listed transactions do not necessarily need to be backed by guarantors or by guarantees provided by the issuer.

Approval: Public issuances require a stamp of approval of the prospectus by CMF, also known as a visa. Private placements do not require a formal "visa" but they must be vetted by CMF.

Issuer Incentives: Companies issuing corporate bonds on the DSX are entitled to a 25% deduction on corporate taxes for a period of up to 3 years.

4. THE STATE OF THE CAPITAL MARKET

There are two stock-exchanges**: Bourse des Valeurs Mobilières de l'Afrique Centrale (BVMAC) in Libreville (Gabon)** and **Bourse de Douala (DSX) in Cameroon.**

Overall activity of both exchanges is weak: only 4 companies are listed on the two exchanges in total. Capital market activity in the CEMAC area is minimal: primary issuances are scarce and secondary market is virtually non-existent.

1.1. Main bottlenecks affecting capital markets development

i. **Lack of integration:** There are 2 stock exchanges (BVMAC and DSX), 2 supervisors (CMF and COSUMAF), 2 settlement banks (BEAC, SGBC), and 3 central depository participants (BVMAC, CAA and CRCT).

ii. **Complexity of the ecosystem**: The existence of two supervisors increases the complexity of transactions. For instance, distribution permits must be obtained from both supervisors.

1.2. Instruments

i. Titres de creances negociables (TCN)

In 2015, COBAC authorized private and public companies to issue commercial papers and certificates of deposits (only for financial intermediaries).[3] A TCN must be guaranteed by a financial institution or by any other specialized entity.[4] Issuers of TCNs need to be authorized by the BEAC, the Central Bank, following an assessment of the plan of issuances and the financial position of the issuer.

Type	Duration	Authorized issuers
Billets de tresorerie	< 2 yrs	Private companies (non-Fis) and State
Bons a moyen terme negociables	> 2 yrs and < 7 years	All firms (Fis/ non Fis, private and State-owned), State, DFIs

Source: Reglement 04/2015 COBAC

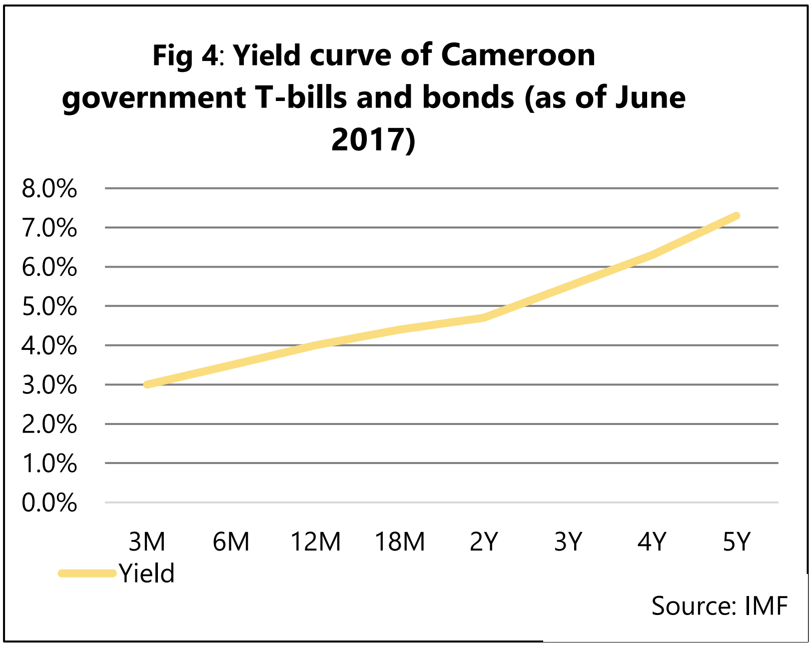
TCNs are open for investment to all categories of investors, including retail and non-resident. Beside the issuer, only brokerage firms and financial institutions are allowed to promote those instruments across investors. As the instrument is still new in the market and regulatory framework is yet to be completed, investment activity and issuances are still minimal.

ii. Sovereign Bonds

The most commonly used venue utilized by the State for issuing shorter term notes are the **tenders that BEAC organizes on a regular basis** on behalf of the six states of the CEMAC zone. Tenders are organized on the basis of a fundraising plan (by product and maturity) elaborated by each State. banks which have received a special agreement (**Specialistes en Valeurs du Tresor – SVT**) from BEAC. Banks constitute the main bidders, often bidding both on proprietary trading and on behalf of their customers. Instruments available are: i) Bonds du Tresor Assimilables (BTA), i.e. short-term notes of 13, 26 and 52 weeks, and ii) Obligations du Tresor Assimilables (OTA), medium-term notes of 24 and 36 months.

[3] Reglement 04/2015 COBAC.

[4] Financial institutions respecting CAR ratio of COBAC are exempted from rating requirements.



Long-term bonds are issued on the stock-exchange. **DSX is currently the most liquid stock exchange for sovereign bonds in Central Africa.** The State of Cameroon has been the main player on the DSX since its creation in 2011; since then, it has issued four listed bonds. The latest (2016) was a five-year bond with a net interest rate of 5.5%. Other issuers of bonds on the DSX include development banks such as the **IFC** – which issued a 5-year bond in 2009 (i-rate: 4.25% net), Banque de développement des Etats de l'Afrique centrale (**BDEAC**) paying a net interest-rate of 5.5% and **FAGACE** (i-rate: 5.25% net).

1.3. Costs of Issuing Corporate Bonds

The table below shows estimated costs of bond issuances, which are significantly higher than typical costs in more developed markets.

Function	Entity	Cost	Cost Base
Structuring	PSI	1%-2%	Transaction size
Listing	DSX	0.09%	Residual amount listed
Guarantee	DFI	2%-4%	Guaranteed amount
Investing	Investors	>6%	

1.4. Tax regime for foreign investors

Foreign investors buying unlisted securities are subject to a withholding tax (WHT) of 16.5% (15% in case of French investors). However, WHT for DSX-listed securities is significantly lower: it varies between 5% and 10%, depending on the maturity of the instruments.

1.5. Constraining factors limiting issuance of corporate bonds

- **Lack of sufficient intermediaries:** Most PSIs are owned by banks (as spin-offs and more commonly, internal departments of banks) which prevents them from looking for alternative ways to finance corporates. PSIs are currently only structuring sovereign bonds transactions, which are too big for banks to finance on their own.
- **Lack of transparency and poor corporate governance across Cameroonian corporates:** Many corporates in Cameroon are family-owned businesses characterised by poor or non-existent corporate governance structures with little accountability. These firms are not keen on opening up ownership to outsiders and are not willing to share their businesses' financial and operating information.
- **Insufficient knowledge on financial securities by corporates:** Corporates lack technical understanding of financial securities such as bonds and stock issuances, thus prefer to rely on bank

financing for their businesses where necessary. However, many corporates are owned by wealthy ethnic groups, and are often able to raise funds via their peer entrepreneurs without the need of bank financing.

Some key recommendations include:

- **Promoting informative actions to create momentum** with stakeholders (particularly potential issuers and brokers);
- **Providing technical support in structuring transactions** alongside brokers (training on assets and liabilities management; sessions on the steps to take to raise capital via alternative instruments, benefits of issuing bonds versus a bank's loan etc);

1.6. Intermediaries

i) Brokerage firms

Majority of brokerage firms/**PSI (Prestataires de Service d'Investissement)** in Cameroon are owned by banks, which acts as a disincentive for them to aggressively look for transactions to structure and to bring to the market.

All PSIs in Cameroon are focused on structuring and distributing sovereign bonds. Private placements are rare, and only arranged in exceptional circumstances: e.g. when the internal resources of the banking system are not sufficient to satisfy the borrowing needs of the customer or when there is no appetite for a given transaction across banks.

ii) Settlement bank

SGBC is the settlement bank of the Cameroonian financial market.

iii) Depository Participants

There are 2 Depository participants (DP) in Cameroon : (i) **Caisse Autonome d'Amortissement** (CAA) and (ii) **Cellule de Règlement et de Conservation des Titres** (CRCT). DPs link investors to the Depository which in turn has electronic links with the Stock Exchanges.

5. POTENTIAL ISSUERS

i) **Banks: Most commercial banks are currently financing long to medium term assets (up to 7-10 years),** with short term liabilities (up to 3 yrs). To this extent, corporate bonds represent an option for rebalancing their maturities. Banks have cited the following reasons for not issuing bonds:

- Deposits in Cameroon have been relatively stable in recent years, so most banks consider the maturity mismatch risk to be insignificant
- Insurance companies lack financial instruments to invest their premiums and deposit significant resources with the banking sector, creating a liquidity glut
- Banks believe that issuing bonds might send a bad signal to the market ("that bank is facing financial challenges")

ii) **Microfinance Institutions:** There are three categories of MFIs (or Etablissements de microfinance - EMF) in Cameroon: Category 1 MFIs - Credit unions; Category 2 -deposit-taking limited companies; and Category 3 - non-deposit taking MFIs. As of November 2016, there were a total of 412 licensed MFIs in Cameroon of which 121 were Category 1, 42 Category 2 and 3 Category 3. The rest are MFIs which are part of large cooperative networks such as CAMCULL (170), UCCGN (9), A3C (34) and CMEC (27). Over half of the total amount of the industry's deposits is concentrated in two MFIs: CAMCULL, the umbrella of credit unions in Cameroon, and Credit Communautaire d'Afrique (CCA).

Most MFIs continue to rely on term deposits from insurance companies which often have a short tenor (1-3 years) and can be easily withdrawn. This further highlights the need for MFIs to look for alternative sources of financing such as corporate bonds as a source of longer-term funds.

iii) **Finance Companies:** Finance companies **(Etablissements Financiers**) are regulated credit-only financial institutions set up to finance medium to long-term assets such as cars, machineries and real estate. There are 7 finance companies in Cameroon: Africa Leasing (ALC), Alios Finance, Credit Foncier du Cameroon (CFC), Pro-PME, Societe Camerounaise d'Equipement (SCE), Societe de Recouvrement des Creances du Cameroon (SRC) and Societe Nationale d'Investissement (SNI). They mainly refinance their portfolios either via credit lines from banks or DFIs or via deposits from institutional investors, which are not always sufficient to meet their needs.

iv) **Non-FI Issuers: There are ~40 non-FI companies that could be potential issuers of corporate bonds,** but there is need to provide technical support and capacity building to guide the firms through the issuance process.

6. POTENTIAL LOCAL INVESTORS

Potential institutional investors in Cameroon include insurance firms, banks, the national social insurance fund-Caisse Nationale de Prevoyance Sociale (CNPS), Societe Nationale d'Investissement (SNI) and Societe Nationale des Hydrocarbures (SNH). All potential institutional investors demonstrated strong appetite for long-term instruments such as corporate bonds which are lacking in the country.

A lack of sufficient corporate guarantees is a challenge, as most Cameroonian investors are conservative and would require one or more of the following guarantees:

- A letter of guarantee from a local commercial bank
- Tangible assets (land, buildings)
- A guarantee from the shareholders
- A cash collateral

7. ISSUING A CORPORATE BOND IN CAMEROON: NEXT STEPS

The following aspects present a supportive environment for corporates to access capital markets for financing:

- the regulatory framework is in place for the market to work effectively;
- institutional investors are in need of long-term investment opportunities;
- banks' liquidity levels are decreasing which should stimulate the market in the coming years.

ALCBF can play a pivotal role to stimulate the market by offering technical assistance to potential issuers to support the transaction structuring and marketing.

Research and reporting that forms the basis of the Cameroon assessment has been completed by Varcando Limited on behalf of the ALCB Fund Technical Assistance Facility.

DRC

1. THE MACRO ENVIRONMENT

Government reform programs have been successful in managing inflation, improving growth prospects and improving the exchange rate prospects. Specifically, hyperinflation has been contained, from historical highs of 3-digit percentages, to about 50% per year, albeit still very high.

GDP growth continues to fluctuate sharply, having increased from 7.1% in 2010 to 9.5% in 2014, before declining to 2.4% by 2016, primarily as a result of the economic crisis, political instability, the drop-in copper and oil prices, which account for 95% of the country's export earnings, and the worsening currency depreciation.

The USD/CDF exchange rate has been trending unfavourably, especially since the decision was taken to let the Congolese Franc float. The exchange rate was strained in 2016 and the first quarter of 2017, resulting in depreciation on official and parallel markets of 2.9% and 4.4% respectively. Foreign exchange reserves have depreciated by more than 50% compared to 2014, from USD 4,522.11 million to USD 2,568.34 million at the end of March 2017.

In addition, the overall budget deficit tripled to 1.1% of GDP at the end of 2016 and is increasing, while the decline in gross international reserves becomes larger.

While the country is undergoing reconstruction after the throes of the civil war, the following constraints must be addressed: (i) the deficit in infrastructure services; (Ii) the poor quality of governance and the lack of institutional capacity; and (iii) a poor business environment. The recent elections and political crisis impacted investors' incentives negatively, and the outlook for medium-term investments remains bleak, exacerbated by the high economic risk in the country.

2. FINANCIAL SECTOR OVERVIEW

The Congolese financial sector is organized into two main pillars: the regulatory pillar and operational pillar.

2.1. The regulatory framework

The financial sector is jointly regulated by three entities:

- The **Ministry of Finance** exercises supervisory authority over the players and activities of the financial sector (commercial banks, credit institutions, microfinance institutions, insurance companies and other financial institutions), subject to the special status of the Central Bank of Congo, of which it monitors the management, and particularly the situation of the general account of the Treasury. The Ministry of Finance is in charge of mobilization of the State's internal and external resources.
- The **Central Bank of the Congo (BCC)** has a general mission to implement the country's monetary policy in order to ensure the stability of the general level of prices and national currency, both internally and externally. The central bank currently has a negative balance sheet and continues to accumulate losses on its administrative and monetary policy operations. At the same time, its position continues to weaken vis-à-vis the State, which intervenes to finance its losses. The recapitalization and restructuring of the BCC have been initiated but are slow to impact the institution sustainably.
- The **Insurance Regulatory and Control Authority (ARCA)** was established in 2016 under the Insurance Code, Decree 16/001 of 26 January 2016 ton regulate the insurance sector following its

liberalization. At present, the National Insurance Company (SONAS) remains the dominant actor in a quasi-monopoly situation, but ARCA is already working on the first applications for registration of local promoters and foreign financial groups willing to permeate the Congolese insurance market.

2.2. The operational pillar

The banking and microfinance sector

The financial sector remains marginal and poorly developed: less than 1% of the population has access to a commercial bank, and only 7% of companies use banks to finance their investments. Local financial services are offered by savings and credit cooperatives, NGOs, microfinance institutions, money transfer companies, and more recently by new specialized banks and some banks exploring the mass banking market. The banking sector is highly concentrated in Kinshasa, although some banks have opened branches in other major cities such as Lubumbashi, Kisangani, Mbuji-Mayi, Kananga, Goma, Bukavu and Matadi. There are 20 licensed banking institutions with a total of 94 branches.

The monetization of the DRC economy is also very low by international standards. The broad money supply represents less than 17% of GDP, against an average of about 46% in sub-Saharan Africa. At the end of February 2017, the overall assets held by the banks amounted to USD 3.725 billion, representing approximately 86% of the total assets of the financial system, and 85% of bank deposits are denominated in US dollars.

Due to the weak regulatory and legal system, the use of guarantees/collateral loans is limited, compelling commercial banks to lend only to a small number of companies and individuals. The activity of the banking and microfinance sector is characterized by four main elements that have an impact on the planned issuances:

- **Dollarization of the economy**: US dollar deposits constitute 90% of deposits collected by banking institutions, and dominate loans and overdrafts at 90% and 45% respectively. This indicates the weakness of financial resources in the local currency.
- **High exchange rate volatility:** The Congolese Franc is a volatile currency whose exchange rate against the USD fluctuates widely and is depreciating. This increases the price of staples and heightens the lack of confidence in the national currency
- **The lack of long and medium-term practice**: Inflationary pressures and the lack of long-term savings instruments limit the ability of commercial banks to finance investments, and justifies short-term behavior. Long-term loans denominated in Congolese Francs are virtually non-existent and have particularly high rates when they are granted. Long term loans denominated in USD are mostly for exporting companies – like mines for example.
- **High interest rates**: The interest rates issue fundamentally differs depending on the currency. The currency dualism (Congolese Franc - US dollar) leads to two different types of interest rates. Since January 18, 2017, the interest rates applied by the BCC on the Congolese Franc money market are 21% for the standing facilities, 14% for the short-term policy rate, and 14% for 7-day BCC bills, while the annualized inflation rate as at June 2017 was 50.83%. Interest rates for interbank US dollar loans are ~ 0.5 to 1% per month, while rates charged by commercial banks on loans to customers are ~1.50% per month for consumer credit (in local currency)[5].

[5] Source: http://www.bcdc.cd/fr/les-produits/les-credits/ rubrique crédit Kiti.

The insurance sector

The National Insurance Company (SONAS) has monopoly in the DRC insurance market but has recorded poor performance over the years, with loss of confidence from clients and reinsurers, a precarious financial situation, an excessive number of staff, and poor-quality services.

Moreover, insurance in the DRC is underdeveloped with a penetration rate of 0.4% compared to approximately 1.5% in neighboring countries. According to the study, the DRC, which has more than 75 million inhabitants, can offer mobilization opportunities totaling nearly USD 500 million, i.e., an average of 5 million risks billed at 10 dollars per month for different local products.

Social Security

With the August 2016 promulgation of the law on the organization of the social security system, contributions to the National Institute of Social Security (INSS) have been increased from 12.5% to 20%, and the retirement age for men and women increased to 65 years. The law was also amended to require at least 15 years of social security contributions by workers to qualify for retirement benefits, as opposed to the previous requirement of only 36 months.

From an asset-liability management perspective, the National Institute of Social Security must be able to find backing financial products for its technical reserves. The INSS's assets are currently composed mainly of bank deposits and investments in the money market as there are no long-term investment opportunities. This has a negative implication on the fund's asset liability management.

3. LEGAL AND REGULATORY FRAMEWORK

The **Uniform Acts of OHADA** set the regulatory scene for the organization and functioning of corporate bond markets. The Democratic Republic of Congo joined the OHADA and endorsed the Community legislation that regulates corporate securities markets.

The Uniform Acts of OHADA are particularly extended to conditions for the operationalization of corporate bonds. This is the body responsible for regulating the financial market. The Ministry of Finance can take over where the OHADA fails. However, the Ministry of Finance is responsible for examining an application for a public offering of corporate securities.

Under the Uniform Act of OHADA, securities issuances by commercial companies to few institutional investors do not require authorization in principle, as the transaction is excluded from the area of competence of the Financial Market Regulator due to the non-solicitation of savings from a non-professional public.

There are **no regulations under the banking law that guide or prevent issuances by a credit institution or microfinance institution.** In addition, the Banking Act does not preclude banks from participating in loan syndications, and to perform transactions such as the investment, purchase, management, custody and sale of securities and any financial product. Interbank lending is also allowed under the banking regulations, and there are ongoing longer-maturity inter-bank loan transactions.

4. THE STATE OF DRC'S CAPITAL MARKETS

4.1. Existing market structures

Money Market

The money market, which includes the Central Bank, covers the refinancing of commercial banks, as well as auctions of Central Bank of the Congo's BCC-Bills. The weekly auction of BCC-Bills is the main market tool used to meet temporary monetary shocks such as a sudden spike in government spending or a surplus of commercial bank reserves.

Tbills have maturities ranging from 7 days, 28 days and 84 days. The treasury bills are tradeable, making it possible for a secondary market to evolve. In addition, the Central Bank sets a ceiling interest rate which protects against an escalation that would increase the cost of monetary policy.

Interbank market

The interbank market in the BCC clearing house allows banks with a cash deficit to find resources in Congolese Francs from banks that have surplus cash. The banks use the services of foreign correspondents for the settlement of their USD-denominated transactions. These correspondent accounts represent over 25% of banks' assets and over 95% of activity in the interbank market. They allow banks to settle transactions denominated in US dollars, reflecting efforts to hedge against local political risks and settlement risks.

In order to take control of dollar offsets, the BCC joined the Regional Payment and Settlement System (REPSS) in March 2015 and signed two agreements for this purpose. The first was with the COMESA Clearing House and the second with the settlement agent, which is the Central Bank of Mauritius. The REPSS system allows economic operators in the area to make ad hoc payments in real time at lower cost and without involving the usual foreign correspondents or other intermediary banks. However, no statistics could be obtained about it in order to assess the impact of this provision.

Financial instruments market

Public offerings of long-term debt are restricted to money market transactions carried out specifically for short-term financial products. Moreover, the monetary authorities do not use the BCC-Bills as a real debt instrument, but rather as a mere instrument for liquidity control. The particularly short-term BCC-Bill has no secondary market.

To date, no trading platform has been set up for financing by means of medium- and long-term securities. Public offering of financial instruments is non-existent. Some limited fund-raising initiatives do exist, however, and have enabled the financing of major national projects (Congo Airways and CoMinière). Interbank loans excluding call money are rare, but still perform bilaterally between banks on the basis of rates of return and freely negotiated collateral.

4.2. Government securities

Government securities may be issued by the central State (Sovereign bonds, Treasury bonds, Treasury bills, etc.) or by a government body benefiting from its guarantee. Apart from the issuing of short term (maximum 84 days) tradable treasury securities, the government securities market is highly underdeveloped.

In 2016, rating agency Standard & Poor's (S&P) maintained the country's sovereign rating at "B-", but with an outlook downgraded from "stable" to "negative" owing to the decline in foreign exchange reserves, the rise in current account deficits and electoral uncertainties. Reforms promoting further consolidation of the State's budget management, an improved monetary policy that stabilizes the exchange rate and contains inflation and interest rates, adequate budgetary discipline, and the strengthening of legal and judicial security would create the basic macroeconomic conditions for considering a longer-term debt market.

Key considerations

- **Demand for long term credit:** The DRC government requires long-term financing for infrastructure and other development projects, but banks cannot provide this long-term financing requirement due to their short-term liabilities and limited access to long term capital. Thus, the government is considering a potential issuance of a long-term bond to meet its long-term capital needs. However, the long-term bond market is currently non-existent, with no existing issuances.
- **Availability of savings (short term deposits) and lack of longer-term deposits:** Banks have access to short term deposits often saved in current accounts, in addition to undocumented savings available within the informal financial sector. Banks have high liquidity and are unwilling to commit to longer-term commitments exceeding 6 months.
- **Potential for developing a liquid, transparent and fair secondary market :** A secondary market allows security subscribers to sell securities before maturity, thus creating liquidity. For a secondary market to exist, there must be a trading platform, intermediaries and a transaction settlement system. However, transitional arrangements can be utilized in the absence of the prerequisite secondary market infrastructure.
- **Settlements:** Transaction settlements for USD loans must be made via bank correspondents located abroad, interest rates can be fixed. With local currency loans, settlement can be made via the Central Bank of Congo, which will improve its ability to monitor the country's financial flows. However, given the high volatility of the CDF and high inflation rates, interest rates would need to be set as floating rates.

5. POTENTIAL INVESTORS

The review incorporated views from 8 potential institutional investors: RAWBANK, Trust Merchan Bank, Afriland First Bank CD, FPM S.A. (Fonds pour l'inclusion financière en RDC), CITIGroup, Banque Commerciale du Congo (BCDC), BGFI Bank and INSS (Institut National de Sécurité Sociale).

They expressed a willingness to participate in a medium- and long-term loan issued by a reputable bank or microfinance institution. For all respondents, primary market organization, private placement or syndicated loan is not a decisive factor. However, majority expressed preference over dollar denominated issuances, and reiterated the need for issuances to mirror market rates.

The preference of dollar-denominated issuances over local currency issuances is primarily due to the fact that most economic activities are conducted in US$, despite the government's initiative to "undollarize the economy".

6. ISSUING A CORPORATE BOND IN DRC

7.1. Types of issuances

- **Public offering**: Public offerings require various actors and institutions to support issuances, which are currently lacking in DRC. These include: an ad hoc regulator, a stock exchange, a central depository, a settlement bank, licence commercial players. Given the lack of these functions, public offerings would not be successful.
- **Private placement**: Private placement is a fund-raising technique used, for example, for unlisted companies or issuers of debt securities that do not intend to go public. This transaction has the advantage of being simpler to implement than the public offering. As part of its implementation in the DRC, two options are possible:
  - Contact financial institutions that have expressed interest in participating in such an issue of bonds and sell them their debt obligations;
  - A syndicate of underwriters is formed for each issue with or without a bought deal (a security offering where a syndicate of banks commits to buy all or part of the offering from an issuer and sell it to investors). A managing underwriter may be appointed by the company from selected intermediaries.
  - There are no regulatory obstacles to issuing securities via private placement.
- **Syndicated loan**: In the issuance of a syndicated loan, there is no tradeable security as is the case with bonds. To carry out such a placement, Issuers would need to contact interested potential investors for a loan that is spread among lenders.

7.2. Summary of recommendations and conclusion

Given the characteristics of the needs expressed by prospective issuers and the legal, financial and institutional environment of the DRC, we recommend the following:.

- **Issuance in USD or Congolese Franc**: Given that the economy is highly dollarized, potential investors prefer to participate in a debt issue denominated in dollars. Subscriptions would therefore be in USD, as would interest payments and amortization of principal.
- **Maturity of debt securities and liquidity requirements**: Since investors in the DRC operate mostly in the short-term, an issuance of 2-5 years maturity could only be made if a minimum liquidity guarantee mechanism on the secondary market. To facilitate longer-term issuances, it would be important to make use of constant amortization on a semi-annual or annual (even quarterly) basis.
- **Interest rate**: Interest rates are only formally regulated by the BCC for transactions in Congolese Francs. The report recommends US Dollar issues at a fixed interest rate that would be close to market rates for short-term interbank loans of around 1% per month. The interest rates to be considered for each of the two issues, will depend on the aggregates specific to each issuer, maturity, liquidity, total or partial guarantees for payment of interest and / or repayment of capital by an entity other than the issuer, as well as current economic conditions

LIBERIA

1. THE MACRO ENVIRONMENT

1.1. Economic Overview

Liberia's economy has been unstable over the last 15 years owing to various economic shocks that affected its stability, including the two civil wars that ended in 2003, an Ebola outbreak in 2014 and a sharp decline in commodity prices that affected its global iron ore and rubber trade. The country recorded an average annual economic growth rate of 5.9% during the 14-year period between 2003 and 2015, hitting a high of 9.5% in 2007. This fell to 0% in 2015, owing to the impact of the Ebola outbreak and decline in global commodity prices.

With a population of 4.5 million and a low GNI per capita of US$320, the country has a limited market size which hampers the development of the country's private sector. Moreover, there is a large shadow economy[6] in Liberia comprised of the legal production of goods and services hidden from public authorities. Firms unwilling to share accurate information about their business activities with regulators are unlikely to supply potential investors with such information.

1.2. Liberia's Dual Currency System and Inflation

Liberia has a dual currency regime under which both the US$ and Liberian $ are legal tender. US$ comprised an estimated 68.4% of broad money (generally understood as the total of both liquid and less liquid money) in January 2016[7]. However, the Government of Liberia (GoL) is implementing measures to gradually de-dollarize the economy. For instance, in 2016 it issued an L$6 billion two-year T-bond in order to absorb Liberian dollar liquidity.

As US dollar serves as the main currency for formal sector transactions in Liberia, the Central Bank's ability to contain inflation is limited. Liberian dollar's depreciation in 2016 pushed inflation upwards to 12.5% by the end of that year. These inflationary risks are likely to decrease investor appetite for long-term investments.

1.3. Interest Rates

Liberia does not have any formal interest rate restrictions, but the CBL institutes an unofficial ceiling on the interest rates that banks can charge on loans, which currently stands at 18%. Liberia's banks primarily rely on T-Bills rates to determine inter-bank lending rates.

Average Commercial Bank Interest Rates (L$ and US$)

	2014	2015	Jan-Nov 2016
Lending Rate	13.50	13.61	13.59
Personal Loan Rate	13.99	14.07	13.94

[6] In 2007 the World Bank estimated that the size of Liberia's shadow economy was 44.2% of GDP, ranking it 125th out of 162 countries analysed. The size will have changed over the past 10 years, but a major shift is unlikely to have occurred. See Friedrich Schneider, Andreas Buehn and Claudio E. Montenegro, 'Shadow Economies All over the World: Estimates for 162 Countries from 1999 to 2007, Policy Research Working Paper, The World Bank, July 2010, http://documents.worldbank.org/curated/en/311991468037132740/pdf/WPS5356.pdf

[7] Central Bank of Liberia (CBL)

Mortgage Rate	14.25	14.50	14.16
Time Deposit Rate	4.16	4.05	3.77
Savings Rate	2.00	2.00	2.03
Rate on CD'S	2.25	2.00	2.14

Source: Central Bank of Liberia

1.4. Access to Credit

Access to credit from domestic sources is very limited. However, as there are no controls on inward and outward capital flows in Liberia, companies can raise large capital amounts from overseas markets. As a result, the proportion of domestic credit to the private sector sourced from domestic commercial banks is only 20.4%.

2. FINANCIAL SECTOR

Liberia's banking sector

There are nine commercial banks and one development bank that are liquid and well-capitalised. In December 2016, the sector recorded a capital adequacy ratio of 21.5% and liquidity ratio of 51.4%. The industry assets stood at US$845 million in 2016.

The loan portfolio of Liberia's banks is dominated by US dollar denominated loans. As of December 2016, their USD loans to the private sector amounted to US$368.3 million with a loan to deposits ratio of 26.2%, compared to L$2,670.7 million (approximately US$27 million) in local currency loans with a loan to deposits ratio of 82.8%.

Earnings have remained low due to high operating costs, a high share of non-performing loans (NPLs) and fraud. Confidence in Liberia's banking sector was recently weakened following the closure of First International Bank of Liberia Ltd's (FIBLL) which was sold to a Ghanaian private equity fund in 2016 and re-established as the GN Bank Liberia.

3. THE STATE OF LIBERIA'S CAPITAL MARKETS

The development of Liberia's Money and Capital Markets stalled following the two civil wars and remains subdued due to various factors including: greater prioritisation granted to other areas of financial markets development, limited supply and demand for securities and poorly perceived GoL financial instruments following its failure to repay investors for the mandatory savings bond scheme of 1981.

The Government of Liberia (GoL) began to issue securities again in mid-2013, starting with 91-day Treasury Bills. Since then, the market in government debt securities has gradually progressed, leading to the issuance of a two-year L$6 billion bond in 2016, to absorb Liberian Dollar liquidity. Between September 2013 and August 2016, the GoL raised over US$200 million from the monthly issuance of Treasury Bills, and around US$60 million from the issuance of its two-year Treasury Bond.

3.1. Corporate issuance: past and potential

Since 2003, only two transactions appear to have taken place:

- In **2010** telecommunications company **Cellcom issued debentures worth US$7 million** through a **mixed private placement and public offering**. The debentures had a maturity of five years and offered minimum annual interest payments of at least 10%.

  There was little public interest, and the underwriting bank reportedly took up the entirety of the private placement.

- In **2010** the **Liberian Bank for Development and Investment (LBDI) raised capital through a public offering.** Hoping to raise around **US$ 10 million in equity**, the offer only resulted in 50 new shareholders. Most investors were existing shareholders, and **Liberian investors only subscribed ~ US$ 300,000**; the remainder was raised through loans instead.

THE LEGAL AND REGULATORY FRAMEWORK

Legal Provisions

Liberia's capital markets regulatory framework is underdeveloped, but discussions on reforms are underway. In December 2016, the House of Representatives passed the Securities Market Act and Central Securities Depository Act, which pave the way for the creation of a stock exchange, central securities depository, and securities and exchange commission (which would be the capital markets' regulator) [1].

Corporations can issue bonds under Liberian legislation, but few specific requirements, provisions and protections related to such transactions exist:

- **Debt structuring requirements:** No specific restrictions in legislation or CBL regulations on how to structure debt.
- **Requirements for private placements and public issuances:** The Securities and Markets Act (SMA) requires that the Commission (or, in the interim, the CBL) approve the Prospectus. Issuances to less than 50 investors in a 12-month period are considered as a private placement have lower requirements on reporting.
- **Legal provisions and considerations for different types of investors and intermediaries:** No restrictions on who can be an investor, just that Issuers or Intermediaries must be licensed by the Commission or CBL and a requirement that they be "Fit and Proper".
- **Debt limits:** No stated limits in the Association Law concerning debt and issuance of debt instruments.
- **Bankruptcy protection:** Bankruptcy is currently covered under Liberian Commercial Code of 2010. An Insolvency Bill was passed by the House of Representatives in 2014 and is still awaiting Senate approval. While legislative protection is weak, CBL has the power to impose upon an issuer measures that may afford necessary protections not stipulated by law.

Regulatory authority: The Central Bank of Liberia

In the absence of a securities and exchange commission, the CBL holds all regulatory authority.

In January 2017, the CBL established the Financial Market Department, which is currently headed by Mr Amaso Bawn. Steps towards making this department autonomous are expected to take place by Q3 2017.

4. POTENTIAL LOCAL INVESTORS

Commercial Banks

Local currency loans-to-deposits ratio is 26.2%, while the ratio for US Dollar loans-to-deposits is 82.8%. Commercial banks are keen to reduce their non-earning Liberian dollars, but they have some concerns:

- **Views on the legal and regulatory framework:** The current system does not support bond issuance, given the underdeveloped regulatory framework, limited legal assurance against defaults, and CBLs perceived limited capacity to regulate a growing capital market. Furthermore, while a collaterals registry was recently established, secured bonds would only partially allay commercial banks' concerns, since liquidating a security is challenging in Liberia.

  Potential investors would require guarantees from the CBL and the parent company (or shareholders) of any firm issuing a bond. One bank executive stressed the need for a "comfort letter" from the CBL to reassure potential investors.

- **Macro environment**
  Several commercial banks pointed out that recent inflation increases, driven largely by the Liberian dollar's deprecation, reduces their appetite to invest in bonds with a tenor of more than three years.

- **Political risk**
  There is little political risk in issuing a local currency corporate bond as corporate bonds would not stand in direct competition to government-issued debt securities, largely because the GoL does not rely on its T-Bills or bonds to cover state expenditure.

Other Possible Investors

- **NASSCORP:** In 2014, the National Social Security & Welfare Corporation (NASSCORP) had an investment portfolio of US$39.5 million, of which 63% was invested in real estate, 33% in financial assets, and 4% in loans and guarantees. NASSCORP would consider investing in a non-sovereign local currency bond. Any decision would, however, hinge on the CBL's attitude and would require approval from NASSCORP's Board, which signs off on all investment decisions.

- **Insurance companies:** As of October 2016, Liberia's insurance companies controlled total assets of ~L$4.4 billion (approximately US$44 million), and investments worth L$831 million (approximately US$8.3 million). Most Liberian insurance companies are brokers with larger offshore insurers backing them. Insurance Company of Africa and Atlantis Insurance expressed openness to the idea of investing in a corporate local currency bond, but stated that any decision would be based on the CBL's position and attitude towards the investment.

- **Telecommunications companies:** Lonestar/MTN and Cellcom could consider investing in corporate bonds in future when business prospects improve.

- **Independent fund managers:** The ***West Africa Venture Fund***, ***ManoCap***, and ***Liberia Economic Impact Fund***, either currently have investments in Liberia or have explored opportunities in the country. These funds have primarily focused on equity investments in SMEs in Sierra Leone and Liberia. Another regional fund with a demonstrable interest in Liberia is the ***Ghana Growth Fund Company (GGFC)***.

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5. STRUCTURING A CORPORATE BOND IN LIBERIA

Key considerations

- **Liberian legislation demands few reporting requirements**, but prospective investors will require detailed financial and legal information, especially in the absence of a ratings agency.
- **Little protection is afforded to investors in the event of a default**, so an agreed form of guarantee will be necessary.
- **Potential investors and the CBL appear to have a limited understanding of how a local currency bond market would work in practice**, so a period of advocacy (or "sensitisation") will be necessary.
- **In the absence of a developed legislative and regulatory framework,** the CBL has significant authority to act in Liberia's capital markets. As demonstrated by Cellcom's debentures issuance in 2010, the Central Bank is open to facilitating such transactions.
- **While the CBL has some flexibility to act,** the state of current legislation and regulation, combined with the macro environment, does limit the number and type of transaction options available.
- **A supporting network of intermediaries does not exist**, which means that alternative arrangements will need to be found.

Elements of a Corporate Bond Structure

While the limited legal restrictions accord potential issuers high flexibility in structuring debt security, issuances would need to be sensitive to macro realities and allay the concerns of local investors unfamiliar with corporate bonds. Any bond issuance should consider the following:

- Incorporate an amortising rather than bullet structure given the perceived level of risk
- Benchmark the interest rates to limit macro risk exposure
- A comfort letter from the CBL pledging that a portion of the issuer's paid-in capital will be apportioned to bond holders in the event of a default[8]

Potential corporate bond structures

	Option 1	Option 2	Option 3
Maturity	**Two years**	**Three years**	**Five years**
Interest rates	**Benchmarked against consumer price index** in order to limit exposure to inflationary risks.	**Benchmarked against T-Bill interest rates** to ensure the returns will be greater, as government securities are viewed as low risk.	
Regularity of interest payments	**Bi-annually**. Most investors expect interest payments to be made on a quarterly or biannual basis. For bonds with a shorter	**Quarterly**. Most investors expect interest payments to be made on a quarterly or biannual basis, with more frequent payments desirable for longer term maturities.	

[8] Given the weak legislative and regulatory framework, the CBL has broad powers to act. While such a letter is not supported by existing legislation or regulations, local investors believe that the central bank would honour such a pledge.

	maturity, such payments can be made on a biannual basis		
Terms	**Amortising** the bond would be preferable because of the perceived risk associated with the issuer making one large repayment.	**Amortising with the option of a buy-back after 18 months**. As local investors are generally uncomfortable to buy long-term debt instruments, the inclusion of a buy-back mechanism could make bonds of three years plus more appealing.	**Amortising with the option of a buy-back after 2 years and the following 18-month period**. As local investors are generally uncomfortable to buy long-term debt instruments, the inclusion of a buy-back mechanism could make bonds of three years plus more appealing.
Security	A mixture of **real estate and paid-in capital**. The difficulties associated with liquidating property means that many investors would feel comforted if the bond were to be secured in part by the issuer's paid-in capital held in a CBL account (assuming that the issuer is regulated by the central bank).		

Potential Intermediaries

Firm	Legal capabilities	Accounting capabilities	Address
PWC Liberia	✓	✓	**Address**: 9th Street, Payne Avenue, Sinkor, Monrovia **Tel**: +231 (0) 770999555 or +231 (0) 888999555
Baker Tilly Liberia		✓	**Address:** FedEx Plaza, 3rd Floor, Suites 1 & 2, 80 Broad Street, Monrovia **Contact person:** Theo Joseph **Tel:** +231 (0) 886516540
Parker & Associates		✓	**Address:** 81 Sekou Toure Avenue, Sinkor, Monrovia **Contact person:** Ernest Parker **Tel**: +231 (0) 880614095
Tubman Law Firm	✓		**Address**: Broad Street, Monrovia **Contact person**: Winston Tubman **Tel**: +231 (0) 880568904 or +231 (0) 770568904

6. RECOMMENDATIONS

6.1. Short-Term: Steps Necessary for Corporate Bond Issuance

- **At this stage, a public issuance would not be advisable; private placements are more viable**. While legally possible, an appropriate regulatory structure does not currently exist and, based on Cellcom's experience issuing debentures, uptake is likely to be limited. Instead, any corporate bond issuance in Liberia would need to take the form of a private placement and incorporate the elements outlined above.
- **Persuade the CBL that credible issuers exist; that local investors are interested; and that corporate bond issuance is feasible**. In addition, it will be necessary to demonstrate how such transactions contribute to broader policy priorities, notably deepening Liberia's financial markets and reducing the economy's reliance on the US dollar. This will require a proposal that outlines what corporate bond issuance would involve, and the CBL actively support the initiative and be willing to draft guidelines.
- **Engage Liberia's commercial banks, NASSCORP and any other interested investors** and help them become more acquainted and comfortable with the idea of corporate bond issuance in Liberia. To be effective, some level of CBL buy-in will be necessary before local investors are approached with such a proposal.
- **Without a network of established intermediaries, organisations capable of supporting the issuance of bonds will need to be identified, or alternative arrangements will need to be explored.** A number of respected accounting and legal firms exist are based in Monrovia, but their ability to perform these functions would need to be assessed.
- **Support the introduction of a mechanism to rate prospective issuers and their debt profiles.** An independent ratings agency active in other West African markets can be engaged to provide independent rating services which will enable investors to evaluate risks involved.

6.2. Long-Term: Supporting Market Development

Longer-term, the development of a local currency bond market will largely be driven by Liberia's macro environment. However, a number of initiatives could be supported to support future development:

- **Conduct a market study to survey private sector interest** which will provide a greater understanding of the extent of private sector interest and encourage the CBL to develop a supportive framework.
- **If the first bond issuances are successful, and the CBL wishes to facilitate further transactions, provide technical assistance to developing regulations.** Capturing lessons learnt and incorporating them in future regulations will be critical to establishing a practical framework governing Liberia's capital markets. If this is of interest, CBL will need expert assistance.

Research and reporting that forms the basis of the Cameroon assessment has been completed by Frontier Research on behalf of the ALCB Fund Technical Assistance Facility.

SIERRA LEONE

1. THE MACRO ENVIRONMENT

1.1. Economic Overview

Following the end of Sierra Leone's civil war in 2002, the country attained an GDP growth rate of 9.28% between 2002 and 2014, and GNI per capita more than tripled, driven largely by the revival of the mining sector, improved government policy, and increased productivity in the agriculture sector. However, the country's economy plunged after 2014, with the unprecedented Ebola epidemic and the collapse of commodities prices, resulting in negative growth of -20.6% in 2015

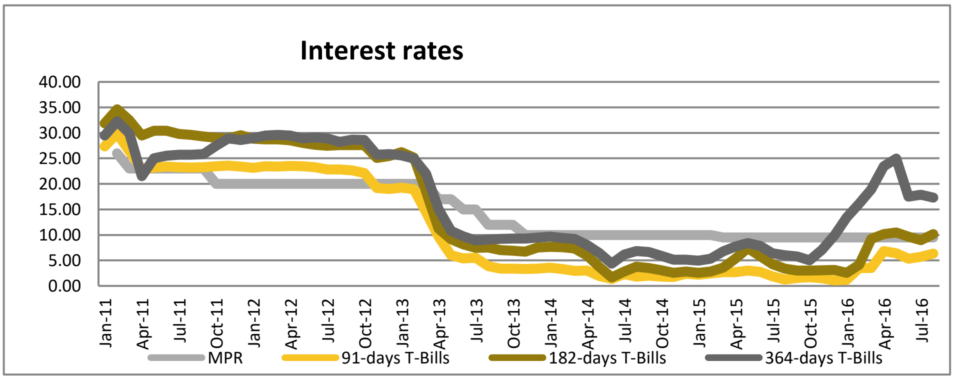
Donor and private sector investment in agriculture, which is responsible for around 50% of Sierra Leone's GDP, is due to increase, and output at the country's largest iron ore mine is expected to double in 2017. Nevertheless, with a population of 6.5 million and GNI per capita of $620,[9] Sierra Leone continues to be a small market comprised of consumers with limited spending power. This imposes clear limitations on the number of private sector companies capable of developing into investible firms.

1.2. Inflation and currency value

A drop in commodities prices and fall in foreign exchange earnings between January 2014 and October 2016 led to a devaluation in Sierra Leone's currency – the Leone – which lost 62.2% against the US dollar, and an increase in inflation by ~40%, from 7.8% to 10.8%

1.3. Interest Rates

Every quarter, the BSL considers whether or not to revise Sierra Leone's monetary policy rate, which serves as the basis by which commercial banks set their interest rates. Other benchmarks used are the rates used for the government's T-Bills.



1.4. Access to credit

Credit financing from commercial banks for businesses in Sierra Leone is limited. Lack of credit information to support banks in evaluating borrowers has exacerbated this challenge. With only one credit bureau in the country which has so far not conducted any private credit coverage, there is lack of a robust mechanism for assessing credit worthiness has stifled the development of credit financing.

Due to these constraints, lending to the private sector remains amongst the worst in the world and regionally. In 2015, domestic credit to Sierra Leone's private sector was estimated at 5.2% of GDP, comparing unfavourably to 20.4% in neighbouring Liberia and 11.6% in Guinea-Bissau.

[9] World Bank data: http://data.worldbank.org/country/sierra-leone?view=chart

2. THE LEGISLATIVE AND REGULATORY FRAMEWORK

2.1. Legal Provisions

Capital markets are primarily governed by the Other Financial Services Act 2007, which provides for the establishment of a stock exchange in Sierra Leone. However, given the stock exchange itself is not operational or active (with three firms listed), only the Companies Act and the Bank of Sierra Leone Act deal specifically with securities in a substantial way. The below table summarizes relevant legislation, the majority of which is addressed in the Companies Act 2009.

Companies Act 2009

Public/Private definition: A firm with more than (less than) 50 shareholders is public (private); private firms are prohibited from making solicitations to the public for the acquisition or disposal or securities. Strict definitions for public and private placements are also given.

Oversight: Part 19 of the Companies Act the right of the Corporate Affairs Commission to oversee the sale of securities (when the issuer is regulated by the BSL it is the primary supervisor).

Investor protection: Investors have legal recourse in cases of breach of contract, negligent misrepresentation, fraud, or other civil and criminal actions. Further, in a liquidation event, shareholders are obligated to proportionally contribute to covering the firm's liabilities.

Debt limits: There are no defined limits to how much debt a firm can raise beyond fiduciary duty.

Investor obligations: The documentation to be provided by the investor will differ depending on the type of investment mechanism to be adopted.

Fundraising mechanism: Companies are entitled (in good faith) to raise debt/financing in any manner they deem appropriate.

2.2. Regulatory Authority

The Corporate Affairs Commission

The Corporate Affairs Commission serves as Sierra Leone's business registry, which manages the companies' incorporation process and acts as the repository for all corporate records in Sierra Leone. In addition, the CAC is also mandated to maintain oversight throughout the investment process and can impose criminal or civil penalties on any company, person or individual that violates pertinent sections of the statute.

The Bank of Sierra Leone

The CAC's supervisory role appears to be at odds with the Bank of Sierra Leone's (BSL) *de facto* supervisory role of the capital markets, which retain oversight of the capital markets until a securities and exchange commission has been established.[10] With the resignation of former Central Bank Governor – Kaifalah Marah – in February 2017, the BSL appears unlikely to assert its authority in this area before the 2018 election.

According to Tapsiru Dainkeh, Senior Director at the BSL, the Central Bank is open to the idea of allowing corporate bond issuances, but will only regulate the transaction in so far as the issuer is a Central Bank regulated entity – i.e. – a bank, microfinance institution or insurance company.

The BSL also made the following points:

[10] The Republic of Sierra Leone, 'Financial Sector Development Plan', 31st October 2009, http://www.bsl.gov.sl/pdf/fsdp.pdf

- Government debt should form the foundation of the capital market, but no adequate framework currently exists.
- Any security would need to be tradeable to give investors an exit strategy.
- BSL is considering increasing the paid-in capital requirements for banks regulated by the BSL from SLL 30 billion (approx. US$ 5 million), which is half the requirement in Liberia.
- The GoSL will see any corporate bond issuance as competition – the banks want to lend and the government wants to borrow.
- Government securities are basically risk free; to be attractive, corporate bonds will need to be more competitive.

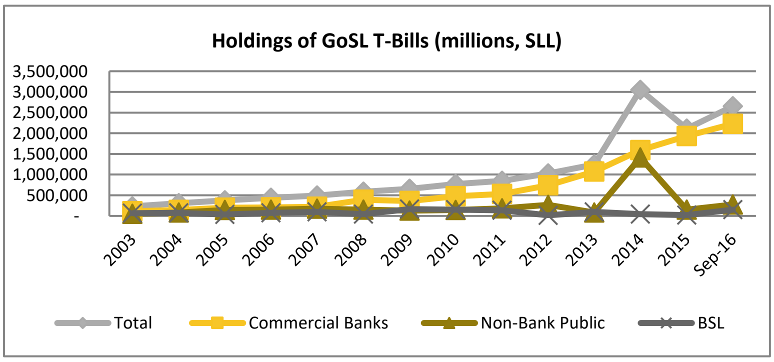
3. THE STATE OF SIERRA LEONE'S CAPITAL MARKETS

3.1. Overview

Given Sierra Leone's fragile post-conflict economy, capital markets are at a nascent stage of development. To date, Government of Sierra Leone (GoSL) and donor efforts have focused on the 2009 development of a stock market (three listed firms) and issuing government debt securities. The stock exchange will continue to be housed inside the Bank of Sierra Leone until a Securities and Exchange Commission (SEC) is created. The BSL has also been working to develop a long-term debt market, primarily focusing on developing government debt instruments and the introduction of "law and regulations to facilitate collective investment schemes 'to allow the formation of investment companies and unit trusts'".[11]

3.2. Government Debt Securities

The GoSL first introduced Treasury Bills (T-Bills) with a maturity of 91 days in 1964, and went on to create a Treasury Bond (T-Bond) with a 12-month maturity in 1993. Between 2003 and 2016, the value of Tbills raised by the Government increased ~6times, from SLL 231.5 billion (approximately $98.5 million) in 2003 to SLL 2.65 trillion in 2016. However, the long-term debt market has not expanded - a two-year T-Bond issued in 2016 was undersubscribed due to low interest rates in a high inflation environment.



Commercial banks have increased their appetite for Tbills, with the value of TBills held by commercial banks having increased from ~53% in 2008 to ~84% in 2016. This is due to high interest rates and limited risks attached. The GoSL, in turn, is heavily reliant on T-Bills to cover expenditure. As a result, the market in government T-Bills limits the liquidity available for commercial actors.

3.3. The State of the Banking Sector

Sierra Leone's banking sector is comprised of 13 commercial banks that, as of December 2015, control assets worth SLL 5.3 trillion (approximately $1.1 billion). Between 2010 and 2015, total assets in the banking sector grew by 113%, from SLL 2.4 trillion (around $600 million) to SLL 5.2 trillion (approximately $1.2 billion) Compared to other West African countries, however, the sector remains underdeveloped, with banking assets accounting for less than 20% of Sierra Leone's GDP, well below the regional aggregate of 31%. Since 2012,

[11] Omotunde E. G. Johnson, 'Financial Sector Reform and Development in Sierra Leone', Working Paper 11/5060, July 2011, International Growth Centre (IGC)

the ratio of non-performing loans (NPL) to gross loans ratio increased from 15% to 32.2% in 2016, but banks have remained profitable as the increased default rate has been offset by growth in investments, especially in T-Bills, and revenues from foreign exchange dealings. Banks' lending activity is low, and interest rates are often extremely high – in Q4 2016 the rates of commercial banks ranged from 9% to 21% – reflecting the high inflation rates and the default risk.

3.4. Intermediaries

Given the state of Sierra Leone's capital markets, a supportive infrastructure of financial information and intermediaries is largely absent: no ratings agency exists and only limited financial journalism is published. However, two discount houses exist that deal in government securities, and a number of respected accounting and legal firms operate in Freetown. The organisations that could perform intermediary functions are:

Name	Strengths	Contact details
First Discount House	Brokerage	Address: 17 Walpole Street, Freetown Tel: +232 (0) 76601108
Direct Discount House	Brokerage	Address: 64 Pademba Road, Freetown
Moore Stephens Sierra Leone	Accounting	Address: 71 Sir Samuel Lewis Road, Freetown Contact person: David Carew Email: docarew@moorestephens-sl.com Tel: +232 (0) 88886691
KPMG Sierra Leone	Accounting	Address: KPMG House, 37 Siaka Stevens Street, Freetown Contact person: Vidal Decker, Managing Partner Email: vtodecker@kpmg-sl.com Tel: +232 (0) 76601595
BDO Sierra Leone	Accounting	Address: 12 Wilberforce Street, Freetown Contact person: Samuel Noldred, Managing Partner Email: Samuel.noldred@bdosl.com Tel: +232 (0) 76624881
Garber & Co	Legal advice	Address: 49 Waterloo Street, Freetown Contact person: Maurice Garber Email: mauricegarber@yahoo.com Tel: +232 (0) 77305754

3.5. Past and potential issuers

There have been a number of debenture issuances since 2002, but information about how they were structured is limited. Based on available information, they appear to have performed with varying degrees of success:

- In July 2006, Sierra Concrete Products Ltd (SCPL) issued a corporate debenture worth around SLL 8.7 billion (approximately $3.5 million at the historical exchange rate). The National Social Security and Insurance Trust (NASSIT) invested in SCPL's debentures and noted in its 2010 Annual Report that that

the company had failed to meet its debt obligations from October 2006. The loan expired in June 2006.
- NASSIT invested in a corporate debenture issued by Kimbina Hotel, and the latter was reportedly able to meet its debt obligations.

Investable firms in Sierra Leone are limited to the few blue-chip firms such as telcos Africell and Airtell, and GSL regulated financial services firms comprised mostly of commercial banks and microfinance institutions..

4. POTENTIAL LOCAL INVESTORS

Commercial Banks

Most commercial banks interviewed displayed reticence about corporate bond issuance in Sierra Leone. While most stated that investment decisions would ultimately depend on the interest rates involved, general scepticism centred on the absence of a regulatory framework and limited capacity of the BSL; the high default rates twinned with weak legal redress; political risks; and macroeconomic concerns.

Commercial bank risk factors

Regulatory concerns: Limited legal framework and internal capacity at BSL to regulate corporate bond issuance. Given limited issuance activity, the BSL's focus has shifted its efforts towards financial inclusion in lieu of developed regulation, as was the aim in the 2009 Financial Sector Development Plan.

Low BSL engagement: Three things are needed for the typically reactive BSL to engage: private sector interest in corporate bond issuance, clear benefit for the GoSL, and evidence of broader economic benefits accruing for the country as a whole.

Default risk: The NPL ratio has risen steeply in recent years to 32.2% in 2016; without mature bankruptcy laws, investors are insufficiently protected. Further, risk assessment is made difficult by the lack of a ratings agency. Guarantees from parent companies combined with BSL assurances could remedy these issues.

Political risk: Bank executives and a former finance minister note the possibility that the GoSL would undermine a corporate bond issuance; while small compared to the $350mn worth of Government treasury bills, such securities compete with government securities used to fund public spending.

Macro risk: Depreciation and resultant inflation raise the risk of long-term securities, limiting some banks to one-year investments in local currency. GoSL's issuance of a two-year bond in 2016 was undersubscribed.

5. OTHER POSSIBLE INVESTORS

Other potential investors include:

- **National Social Security and Insurance Trust (NASSIT):** Sierra Leone's only pension fund, NASSIT, controls assets worth SLL 923.8 billion (approximately $185 million) as of December 2014. NASSIT has invested corporate debentures and T-Bills – but how investment decisions are reached internally is unclear.
- **Insurance companies:** Sierra Leone's insurance sector is comprised of eight companies. Two of the largest insurance companies - Aureol Insurance (assets worth SLL 27 billion (approximately $3.6 million)) and Ritcorp - would consider investing in a local corporate bond depending on the terms offered.

- **Telecommunications companies:** The two main mobile network operators, Africell and Airtel, could consider investing in corporate bonds to manage their foreign exchange risks, but only after their ongoing structural changes are completed.
- **Independent fund managers:** At present, three investment funds have non-extractives interests in Sierra Leone: ***West Africa Venture Fund***, ***ManoCap***, and Cordaid's ***Stability Impact Fund Africa***. These funds have primarily focused on debt and equity investments in SMEs and are unlikely to consider investing in corporate bonds in Sierra Leone.

6. ISSUING A CORPORATE BOND IN SIERRA LEONE: NEXT STEPS

6.1. Key considerations

The main concerns from local investors were as follows:

- **Delineation of regulatory responsibility:** While the CAC is the supervisory body designated to oversee any bond issuance process in the country, this conflicts with BSLs mandate to regulate financial services firms, where the issuer is a bank, MFI or insurance company.
- It is also unclear whether CAC have the expertise and experience to satisfactorily oversee capital markets transactions.
- **Securing the bond:** Given the weak legal protection afforded to investors, some form of security will need to be identified, along with a supportive letter from the supervisory authority. For financial services companies looking to issue a bond, real estate alone will not suffice as collateral. Although such entities have paid-in capital of around $5 million, which is deposited in BSL accounts, the question of whether some of this money can serve as security collides with the issue of regulatory responsibility.
- **Managing political risk:** The political risk associated with issuing a corporate bond is real, as confirmed by the BSL, so all prospective issuances would require informal approval from the Ministry of Finance and Economic Development (MoFED) before proceeding.
- **Incentivising investors:** The core group of potential local investors – Sierra Leone's commercial banks – operate a profitable business model focused on risk-free investments in T-Bills and foreign exchange operations; their incentives to invest in corporate bonds is therefore limited.
- **Engaging with limited market understanding:** Neither the CAC or BSL on the one hand, nor potential investors in Sierra Leone on the other, has a detailed understanding of corporate bonds, so a period of advocacy will be required before proceeding to issuance.

6.2. Recommendations

Short-term

- **Relocate interim regulatory authority to the BSL until a securities and exchange commission is established**. The CAC lacks the in-house expertise to perform this function, and the overlap with the BSL's authority raises questions about Sierra Leone's regulatory framework**.**
- **If relocating authority to the BSL is not feasible, then efforts will need to be made to i) instil greater clarity in the supervisory structure and ii) develop CAC's expertise**. Technical assistance could be provided to draft regulatory guidelines that clearly identify the roles and responsibilities of the BSL and CAC, and provide the latter's staff with training to ensure they are able to fulfil this function.
- **Engage the government on the issue of political risk** given the government's reliance on T-Bills to cover its finances This risk would need to be addressed before a bond is issued.

- **Increase the paid-in capital of financial services firms** to increase security of the bond by mitigating the risks related to the weak legal protection afforded to investors, and the difficulty involved in liquidating real estate assets.

Long-term

- **Engage Sierra Leone's investor community and help them become more acquainted and comfortable with the idea of corporate bond issuance**.
- **Support the introduction of a mechanism to rate prospective issuers and their debt profiles.** An independent ratings agency active in other West African markets can be engaged to provide independent rating services which will enable investors to evaluate risks involved.
- **Conduct a market study to survey private sector interest** which will provide a greater understanding of the extent of private sector interest and encourage the development of a supportive framework.

Research and reporting that forms the basis of the Cameroon assessment has been completed by Frontier Research on behalf of the ALCB Fund Technical Assistance Facility.

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