



One-year horizon to start operation

Electronic stock trading preparing for launch

The privatization of the Beirut Stock Exchange (BSE) and the launch of an Electronic Trading Platform (ETP) were supposed to be jointly implemented by now, but political gridlock is delaying the privatization project. The Capital Markets Authority (CMA) has decided to launch the ETP project first. The CMA has placed the final touches on the tender documents and the tender to select an operator of the ETP will be launched before the end of the year, said *Firas Safieddine*, Vice Chairman of the CMA. Boosting the stock market has become

an urgent requirement as bank lending to the private sector has reached staggering levels. “The growth rate of loans to the private sector will become slower and their cost will become higher. The capital market is the solution,” Safieddine said.

RIGHT TIME FOR ETP

It is time the country’s financial system focuses more on capital markets than banking, according to Safieddine. Companies, especially small and medium enterprises (SMEs) and startups, are finding

it harder to obtain financing. “Businessmen must not only think of securing bank loans, because they have become more costly and almost inaccessible, and they are mainly short term financing,” Safieddine said. Obtaining funding, especially equity financing, through the capital markets is less costly and is a long term answer, he said. The ETP will be the ideal divestment channel for investments made under Circular 331 which must be exited within seven years, according to Safieddine. *Riad Salameh*, Governor of the Central Bank (BDL), said: “We prefer that the participation of the private sector in the planned public-private partnership (PPP) projects to be through equity investment and that debt financing be limited, especially because the debt that the private sector owes to the banking sector has reached 110 percent of GDP.” A proportion of existing bank loans could be securitized and listed as bonds. Such bonds will be among the major items listed on the ETP, according to Safieddine. New loans could also be obtained

through the ETP at a lower cost and in larger amounts. *Jean Hanna*, Deputy General Manager at Fidus, said that business owners who do not want to have partners can obtain financing through the bourse by issuing corporate bonds and by abiding by transparency and governance rules. The interest they will pay will be lower than that paid on bank loans while subscribers to these bonds will earn a higher rate than that generated by deposits, according to Hanna. Securing financing through the capital markets has another useful byproduct, namely enhancing governance standards in the business community. If a company wants to obtain financing from a stock exchange they have to abide by certain standards, directions, and governance and transparency requirements in order to get the money, Safieddine said. "This will be a major shift and it creates more confidence," he said.

BROAD RANGE OF SECURITIES

A broad range of securities will be eligible for listing on the ETP. They will comprise equities, investment funds, exchange-traded funds (ETFs), structured products, corporate bonds, government debt instruments such as treasury bills and Eurobonds, BDL certificates of deposit (CDs), currencies, and derivatives such as futures and options. The CMA will also allow physical trading in gold bullion. "We are creating the regulations and the boundaries to structure derivative products which will be allowed for trading in Lebanon in the future," Safieddine said. He

said that only part of the Eurobonds will be listed, as foreign companies that don't have to list them on the local ETP also hold bonds. According to *John Dagher*, CEO of Julius Baer (Lebanon), banks are currently the only market makers regarding government bonds and listing the bonds will create leverage. "The ETP should start by listing the securities that are already traded over the counter locally," he said. Dagher said that allowing cross listing of international companies makes it possible for investors on the ETP to trade in major global stocks such as Apple or IBM. "This will have many benefits such as attracting more liquidity provided it is well controlled in order to avoid arbitrage trading and mispricing," he said.

Arbitrage occurs when there is a discrepancy between the price of a security in a foreign exchange and the price of its global depository receipt (GDR). Mispricing is less common thanks to advanced technology and the speed and ease with which information spreads, Dagher said. According to Hanna, cross listing is not likely to be introduced in the early stages of the ETP's life. "The decision to cross list the shares of a certain international company is taken by the company itself. So if it sees that this serves its interests it will do so," he said. The company may issue GDRs if there is enough demand for its shares on the local market. "Cross listing could become reality if Lebanon grows into a major capital market platform for the entire Middle East region," Hanna said.

FAVORING SMES AND STARTUPS

There are many family businesses and SMEs that are ready to go public, according to Safieddine and this could be a substantial part of the ETP's activities. "The listing requirements will be much easier on the secondary trading platform, which is for SMEs and startups. We will probably follow the Nominated Advisor (NOMAD) style for launching the ETP," he said. The CMA will nominate a financial intermediary or a financial institution or any licensed entity as the NOMAD for SMEs. The NOMAD will supervise the SMEs and create the required governance and thus the SMEs would not have to hire an employee to be in charge

of governance. Such listing requirements will be less expensive when they are outsourced to the NOMAD. "This makes economic sense as the NOMAD will be providing its services to a large number of companies,

CEDRE-funded projects could act as catalysts

making it cheaper than if each company does it by itself," Safieddine said. There will be more than one NOMAD to ensure healthy competition. "The NOMADs will be motivated to solicit SMEs by offering them such services as listing, governance systems, auditing, and issuing corporate disclosures," Safieddine said. The NOMAD can also represent the SME in dealings with the regulator.

TENDER FOR ETP

The CMA will give parties interested in the ETP tender a three-month period to prepare and submit their bids. Once the winning company is selected, it will be given time to mobilize and to create the ETP infrastructure. "We assume a 12-month process to open shop," Safieddine said. The CMA has already informed concerned parties about the ETP tender and so they have undertaken the required research and they know exactly what kind of securities they will start with, according to Safieddine. The local operator will also partner with a major international operator in order to manage the platform properly. "We hoped that the tender documents that we are now launching were for the BSE in application of law No. 161. But we are five years late. The CMA's board saw that there is no solution but to launch the tender for the ETP," Safieddine said. If the privatization of the BSE was implemented there would be no need for a tender for the ETP, because when the





bourse is privatized the operator can create different trading platforms as part of the BSE including the ETP. In 2017, the Cabinet issued the privatization decree which was not applied because it failed to appoint two interim members on the BSE's board.

OPERATOR'S ROLE

The CMA's request for proposals leaves the operator free to decide on how to proceed with launching the ETP activities. "We gave them extreme flexibility," Safieddine said. "The would-be operator knows beforehand the size of the market and its potential and they know what to start with." The operator must submit a business plan for a minimum of five years showing their vision on how they will run the ETP and the schedule of their activities. "The operator decides which security to introduce, and when," he said. It is in the operator's interest to promote the ETP and launch awareness campaigns. "It's their job to visit SMEs, come up with new ideas and new products. The CMA as a regulator will remain at arm's length from the stock exchange," Safieddine said. According to Dagher, it is important to create awareness of the importance of the stock market amid rising interest rates and a culture of preference for deposits. The ETP will also have to operate 24 hours a day as it will be dealing with markets located in different time zones. "I think the ETP will be able to operate 24 hours a day within one year from launching its operations, when all kinds of securities are listed," Hanna said.

FACTORS FOR SUCCESS

Creating incentives to attract investors to the ETP is largely in the hands of the government. The CMA will also offer incentives to SMEs such as the easing of listing requirements and the NOMAD system. It could also lower the listing fees for funds. "But the CMA cannot offer tax incentives although they are necessary," Safieddine said. There is also a need for new laws to ease the registration of companies. If a company wants to be listed, it has to convert into a joint stock company. "The tax on this conversion is extremely high. If the government writes off the tax for companies wanting to list their shares, this would be a major incentive," Safieddine said. The CMA's tender documents also require the potential operator to bring on board a market maker to trigger trading activities. According to Dagher, incentives must be created to encourage investors to trade in GDRs of foreign securities locally, instead of investing abroad. The ETP could also attract foreign investors in the future. "Foreign investors look for opportunities all over the world and they are ready to invest in cheap and undervalued financial instruments even in farthest places. So they could be attracted to the local market," Hanna said. "For instance the shares of Solidere are undervalued and could be a profitable investment," he said. Foreign investors anticipate future scenarios and when they see good signs they take initiative even before such long term ventures generate

positive outcomes, such as the CEDRE-funded infrastructure projects and the oil and gas ventures, according to Hanna. These projects will also contribute to boosting the stock exchange when they are executed. They could act as catalysts for the ETP, as structured products, government and corporate bonds, investment funds, and ETFs, could be created to finance these projects, Safieddine said. According to Salameh, who is also Chairman of the CMA, investment by the private sector in the CEDRE-financed ventures could be direct or through share and bond offerings on the stock market. "The CMA will take key initiatives to make dealings in local securities similar to international standards and this will reassure the global market," he said. The culture of preferring deposits to other kinds of investment has also changed. "Those who invested in the capital market were few 20 years ago but a major cultural shift has occurred as most decision makers at the helm of many businesses are well-educated young people with global experience," Hanna said. "The new generation has acquired the mindset of veteran global investors, they know very well that depositing money with banks is not the only investment option," he said.

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