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Tuesday 29 September

Panel 4

Securities Markets: How to Lean to Stop Worrying and Love Risk

The panel was moderated by **Richard Banks** (RB), Director Middle East, Euromoney Conferences, with panelists: **Mohammed Assad** (MA), Head of Public Debt Management Unit, Ministry of Finance; **Gamal Khalifa** (GK), Chairman and CEO, Edge Portfolio Management; **Maged Shawky** (MS), Chairman, the Egyptian Exchange; **Hisham Tawfik** (HT), Chairman, Arabeya Online for Security Brokerage. Below are excerpts from the session.

RB: In our pre-panel meeting you mentioned you had a wish-list for the securities market in Egypt. Could you tell what it is?

HT: Firstly, I would like to share with you the major achievements that the CMA and EGX have made. There are 3 important developments: the introduction of e-trade, which has linked the database of brokerage companies to the stock exchange, same day trading, which makes up 20% of my company's trading transactions and has meant that 25% of the EGX is now online, and margin trading, which has been extended to clients by a handful of brokerage companies.

We are looking forward to futures market, which will most probably start with commodities, and expect to return to the dealer system soon. Currently, we are intermediates. We used to be working as principals, but now we can no longer sell from our own stocks. Plans to offer short selling in the market are also in the works.

Elsewhere, people can buy and sell on T, T+1 and T+2, rather than only T and T+2, as is normally the case in Egypt. This is a challenge that we have to investigate and overcome in the coming year if we want to double or triple our current trading numbers. This will also attract more local, regional and international players.

We need a more effective market control. We need online market activity with the brokers. This was supposed to be obligatory for all brokers; however, 55% are still not online. This is crucial as the exchange needs to be able to check the brokers' liability online. We need to integrate the clearing system, if we are to achieve the standard of international best practice. Licensing of all brokerage jobs that deal with clients also need to be regulated.

GK: As an investor, the list is never finished. Investors are always asking for new ideas, new types of securities and new profiles that cater to the bonds side of the sector. Bonds are missing from the market. Customers have to understand the risk of every client and build his own portfolios according to these profiles. If you are really catering to a client that is risk adverse, you should recommend a portfolio with bonds. However, bonds are not available. When you are structuring products, you need to have all available tools at your disposal. When brokers take a position for themselves, they add a new dimension to the market and this adds greater depth to the industry. The market has moved forward, and is expanding, however, there are still some tools missing. You cannot control volatility if you do not have all these tools.

MS: We have to agree, that with the changes that happened in the financial market we are now in a better position. This is certainly true in terms of infrastructure and the regulatory environment. Just one year on, volume has started to bounce back, and new investors are returning to the market. These are all indicators that the industry is in good shape.

For example, to manage volatility as an exchange, through connectivity with brokers, we are currently working with 30 brokers to test the feasibility of creating comprehensive live connectivity for client's financial positions, and how this position relates to their customers. We are pushing for a derivative market, and proposing a simple system that would be very transparent. In terms of trying to convince the public and other markets of these strategies, we have faced some setbacks, however, internally, we still are still convinced of this strategy. The key is to educating the public about it and trying to sell the idea of a simple derivative market. Opposition arose during the heat of the crisis, however, now there is greater awareness of the realities we are proposing.

GK: Whenever a new tool is to be introduced to the market, we have to work diligently to ensure it will be effective. Not all derivatives are poisonous, and this is something we have to explain to customers.

MA: In the bond markets, both the secondary market and liquidity are problems. If we want to reduce rates, but also avoid paying the liquidity premium. Since the government's bonds are held mostly by banks and institutions, they automatically have a good credit rating, meaning that they fall into a good asset class of their own. What are we doing about these issues?

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Well, we are coordinating with Central Bank of Egypt, but unfortunately we have not been unsuccessful in bringing about change yet. Of course implementing change is not easy, settlements are a problem, legality is a problem and taxes are a problem too. As far as brokerage is concerned, a study will be presented to allow brokers to trade in the secondary market. We have already given the broker Beltone the green light to be a primary dealer.

GK: Unless bonds are listed on the secondary market, we cannot access them. Now, when a bank searches for a bond, they may find it, and they may not, so the system is not convenient at all. Portfolios are structured on liquid instruments; they cannot be structured on bonds.

MA: it is highly unlikely that a bank treasurer will sell at a loss.

MS: The bond market is not really part of the EGEX. We have the technology and the space to create a new market, but it has to be one that is highly transparent. Today transactions are over the counter; as long as they stay bi-lateral, they cannot be listed on the exchange. We want them listed on the exchange so everyone can see them. The initiation of clearing cash and opening up the bonds sector, through a clearing house or the Central Bank of Egypt, is very important.

Q&A

Floor: Regarding your comments on allowing brokerage houses to own positions again. Would this privilege be extended to stocks as well? Wouldn't extending this privilege make the market value or volume dependant, and wouldn't this encourage more companies to get listed and thereby decrease the level of volatility in the market?

MS: We intend to start with the ETF and then tackle the underlying active stocks. Approval has to be provided by the EFSA. I would also like to add that regulations force companies currently on the market to increase their free float.

Floor: Regarding liquidity, I think the problem for bonds is in the execution process. Execution costs are very high, and the process is further complicated by the bureaucratic system, which requires the executor to report to 2 entities.

MS: Yes, the execution process is a major problem; it certainly doesn't make things any easier. However, our goal is still to get bonds on the screen, so it will be like the equity market, available for everyone to see.

Floor: Regarding structural problems in the banking sector. It seems that banks have large amounts of liquidity, but that they refuse to use this for loaning purposes. They are not putting enough money into loans and instead hiding it in bonds. The market should be run by the corporate bond sector and not the government. I don't believe that any actors in the market are putting in the necessary effort needed to make this happen. Interest rates seem to be steadily heading in the same direction. If this continues, then I don't see how trading gains can be made. So what I really want to know, is when will see a market maker for bonds? As well as when we can expect to see a screen for bonds, similar to the one we have for the equity market?

MA: We need to see commitment from dealers. For example, if the bank has a two way price for a bond, and its customer buys this bond, but the bank doesn't actually have the bond, the bank will have to look for it. In this case, the most important element will be the bond lending program. However, this will take time.

MS: if you are talking about the screen, we are ready to take this step; all that we need is the cooperation of the issuer and the Central Bank of Egypt.