EVALUATION DEPARTMENT SPECIAL STUDY

# EBRD SUPPORT FOR THE DEVELOPMENT OF LOCAL CAPITAL MARKETS

July 2017

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European Bank
for Reconstruction and Development

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100000
80000
60000
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# Contents

## Abbreviations

| | |
|---|---|
| **ADB** | Asian Development Bank |
| **EBRD** | European Bank for Reconstruction and Development |
| **ETC** | early transition country |
| **EU** | European Union |
| **EvD** | Evaluation Department (EBRD) |
| **GDP** | gross domestic product |
| **IFC** | International Finance Corporation |
| **IFI** | international financial institution |
| **IMF** | International Monetary Fund |
| **JPY** | Japanese yen |
| **LC2** | Local Currency and Local Capital Markets Initiative |
| **LCM** | local capital market |
| **LCY** | local currency |
| **MoU** | memorandum of understanding |
| **OGC** | Office of the General Counsel (EBRD) |
| **OTE** | Hellenic Telecommunications Organisation S.A. |
| **SEE Link** | South-Eastern Europe Trading Platform |
| **SSF** | Special Shareholders Fund |
| **TC** | technical cooperation project (EBRD) |

## Defined terms

**The Bank/EBRD**
European Bank for Reconstruction and Development.

**Central counterparty clearing house**
A central counterparty clearing house is an organisation that helps facilitate trading done in derivatives and equities markets. It is usually operated by major banks to provide efficiency and stability to the financial markets in which it operates. It bears most of the credit risk of buyers and sellers when clearing and settling market transactions. Buyers and sellers provide the clearing house with adequate money to cover trade exposures and obligations.

**Central securities depository**
A central securities depository is an institution that holds financial instruments, including equities, bonds, money-market instruments and mutual funds. It allows ownership of those instruments to be transferred in electronic form through updating electronic records, which are often known as 'book-entry records'.

**Early transition country**
The EBRD launched the Early Transition Countries (ETC) Initiative in 2004 to stimulate economic activity in the Bank's countries of operations that still face the most significant transition challenges: Armenia, Azerbaijan, Belarus, Georgia, Kyrgyz Republic, Moldova, Mongolia, Tajikistan, Turkmenistan and Uzbekistan. More than 50 per cent of the population in these countries lives below the national poverty line.

**Evaluation team (the)**
Staff of the EvD and the consultants.

**Floating rate benchmark**
A floating rate note interest rate, since it is not fixed, is tied to a benchmark such as the US Treasury bill rate, London Interbank Offered Rate (LIBOR), the fed funds or the prime rate.

**Floating rate bond market**
Interest rate change according to money market reference rate.

**Impacts**
The positive or negative long-term effects to which an operation contributes, directly or indirectly, intended or unintended (adapted from OECD, 2017).

**LCM transition impact indicator**
The transition indicator scores reflect the judgement of the EBRD's Office of the Chief Economist about country-specific progress in transition. The scores are based on a classification system originally developed in the 1994 Transition Report, and refined and amended in subsequent reports.

**Operation team (the)**
Staff of the EBRD Banking Department and other Bank departments responsible for the projects.

**Outcomes**
The short-term and medium-term effects directly attributable to operation outputs (adapted from OECD, 2017).

**Outputs**
The products, capital goods and services that result from an operation (adapted from OECD, 2017).

**Results**
The output, outcome or impact (intended or unintended) of an operation (adapted from OECD, 2017).

**Results framework**
A diagram showing all expected results of a project classified as outputs, outcomes and impacts, and the causal relationships among them using a theory of change.

# Executive summary

The European Bank for Reconstruction and Development (EBRD) Articles of Agreement (1991; EBRD, 2013a) established development of local capital markets (LCMs) as one of the Bank's core strategic objectives, committing it to "stimulate and encourage the development of capital markets". Much of the work over the following 20 years to support this commitment was performed by operational units of the Bank as part of their everyday activities, and lacked resources and an overall strategic focus. While a wider range of mainly Treasury department activities had some LCM dimensions, their intent was predominantly to enable the Bank's local currency (LCY) transactions. The global financial crisis highlighted systemic risks from asset/liability mismatches and showed the need for a broader holistic approach, employing a range of interventions to better develop LCMs across the Bank's regions.

The Local Currency and Local Capital Markets Initiative (LC2) was launched in 2010 to achieve more efficient and self-sustained financial intermediation in the countries of operations, through broader use of LCY lending and the development of local capital markets. Initial efforts focused on country-level diagnostics of LCM needs and legal issues designed to guide Bank operations. A dedicated LC2 team was created in 2012 to improve implementation of the initiative. A year later, LC2 was designated as one of three strategic initiatives by Capital Resources Review 4. Shortly thereafter the Bank presented and the Board approved the LC2 strategy to give it full institutional weight and focus.

LC2 strategic priorities largely reflected issues identified by the diagnostic work, including legal and regulatory improvements, developing financial market infrastructure, supporting institutional investors, promoting better transaction efficiency and expanding products. LC2 presented an agreed operational plan for more ambitious and effective LCM engagement for the first time, and identified a dedicated team to help deliver it.

This evaluation is focused specifically on the Bank's LCM development work under the LC2 strategy. It does not assess the substantial amount of work focused on LCY activities, though in many cases this may have had secondary LCM dimensions. It confirms that considerable effort and skill has gone into delivering specific transactions and technical cooperation projects (TCs) in challenging contexts, resulting in discrete accomplishments in numerous cases. The commitment to a higher institutional profile and priority at the level of sector and country strategy and operations laid out in the Strategy depends on the content of new-format country strategies and is not yet observable. Solid evidence of wider contributions to LCMs is limited.

There appears to be a significant disconnect between, on the one hand, the Bank's high but undefined strategic ambitions for the complex task of transforming LCMs and, on the other, its limited actual capacity to accomplish this given choices it has made about resourcing, prioritisation, organisation and collaboration with other institutions. In the absence of substantial steps to narrow this disconnect it is difficult to envisage distinctive LCM results much beyond what has been accomplished to date. Major Bank-wide initiatives now under way (such as new approaches to transition and country strategy) present real opportunities to reassess possible ways forward but would require strategic decisions accordingly. This evaluation suggests that the case for a fundamental reassessment is clear.

## Main findings

### Strategy content and implementation

- While development of capital markets was identified as a core strategic focus for the EBRD, it received limited dedicated resources and focus for the first 20 years.
- Considerable efforts and skill, mainly by the Treasury, were focused on increasing LCY operations, including through changes to the related regulatory and market infrastructure. However, only a limited number of LCM-focused banking transactions were completed; LCMs were largely absent from sector strategies and its treatment in country strategies was uneven.
- The LC2 strategy identified appropriate areas of focus but was broadly cast in activity- and product-driven terms. Quantitative and qualitative outcomes at the level of main target countries were not

well defined and intended results were not well specified. Sequenced operations based on country circumstances were central to the strategy but there is little evidence that this drove interventions.

- Useful early diagnostic work was done on country LCM needs and legal issues but initially this was not widely incorporated into country strategies; LCM action plans were agreed with only two non-early transition countries. Action plans are to be incorporated in prioirity LC2 markets as country strategies are updated, but more alignment is needed.

- Cooperation with other multilateral financial institutions has been limited, mainly to joint assessments and LCY matters connected with specific transactions. The EBRD supports several larger international financial institution (IFI) policy forums, but different priorities and processes have hampered an effective joint LCM footprint in both transactions and policy dialogue. There have been no joint LCM-focused projects.

- LCM transition indicators for 2011 and 2016 show five countries upgraded and seven downgraded; transition gaps narrowed in three countries but widened in six. This is partially due to a change in the methodology of calculating transition gaps introduced in 2013.

## Operations

- LCM support was somewhat increased and diversified after creation of a dedicated LC2 team added a much-needed policy dimension. The Bank invested more in corporate bonds and listed equities, and there are cases of legislative and regulatory improvements. However, volumes were relatively small and any observable larger market effects beyond documentation and issuance process will not emerge for some time. There is thus far no post-LC2 equivalent to the Bank's success in creating a market benchmark index (MosPrime) over a decade ago.

- Standard LC2 products (derivative law reforms, covered bond law) have been efficiently implemented in several cases, but their range in terms of EBRD banking transactions is limited and they do not always directly target country priorities. However, their availibility promotes hedging and creates a platform for financial market intermediaries, including the EBRD, to offer an expanded range of LCY products.

- Impact from portfolio-type investments on LCMs has been largely limited to corporate-bond markets in Romania and Poland where the Bank was an anchor investor; but there is limited evidence that this has lengthened their average maturities. Bond investments in Turkey were accompanied by policy dialogue to create a new bond index. Investments into stock exchanges have had positive effects on corporate governance, settlement connectivity and transparency, but improvements to secondary-market liquidity have been patchy. Investments into institutional investors were very modest.

## Technical assistance and policy dialogue

- Many TCs achieved targeted outputs but often without focus on the larger strategic priorities identified in needs assessments; relatively little TC went to larger countries seen as most ripe for LCM investments. Frequent rapid-response interventions focused on ad hoc needs.

- Technical cooperation needs for the Initiative were projected to be significant. An initial small TC budget has been supplemented on an ad hoc basis (mainly from the EBRD Shareholder Special Fund) but this has proved insufficient. Supplementary donor funding, particularly for European Union (EU) and Turkish markets, has been difficult to obtain, although recent allocations have helped.

## Organisation and resources

- A dedicated LC2 team was created to improve organisational focus and processes to execute the Strategy. But with pre-existing sector and regional reporting lines unchanged it is not clear how strategic and operational choices are made. A steering committee created to guide the initiative has provided limited strategic guidance or coordination and has now been replaced by quarterly liaison meetings with stakeholders.

- LC2 does not have a strategic resourcing plan, and resources appear insufficient relative to its challenges and aspirations. The team relies heavily on external and often short-term resources for staffing; hence, member turnover has been high.

## Recommendations

- Prepare a new LC2 strategy giving substantially greater focus to LCM development, to be approved by the Board. The strategy should clearly articulate the Bank's strategic objectives and its envisaged role and operations. It should also incorporate: alignment with the new 'transition' concept; inclusion of a results framework based on clear performance benchmarks for key target countries; clear definitions of LCM objectives, effects and instruments; a template for treatment of LCMs in new country strategies; and an objective consideration of experience with operations, organisation and resources to date.

- A full resource and organisation plan to execute the new strategy should be prepared, also for Board approval, including organisational structure for decision-making, staff resources in headquarters and resident offices, and funding needs and sources to support TC and policy dialogue, including rapid-response interventions.

- New country strategies should identify whether LCMs will be a priority for operational work and, if so, include specific treatment of LCM development needs and gaps.

- The EBRD should actively consider leading a cross-IFI initiative to encourage greater cooperation in its areas of operation through existing platforms and new means, on diagnostic work, policy dialogue, tackling procedural obstacles to collaboration and targeting joint operations.


# 1

# Introduction

## 1.1. Purpose

Development of local capital markets (LCMs) was identified as one of the European Bank for Reconstruction and Development's (EBRD's) core strategic objectives at its inception in 1991, with Article 2 of the Agreement Establishing the Bank (EBRD, 2013a) committing it to "stimulate and encourage the development of capital markets".

For the Bank's first 20 years LCM development-related activity was dominated by local currency (LCY) operations, primarily concentrated on Russia, Serbia and Ukraine and run outside of Banking by the Treasury and Office of the General Counsel (OGC) Finance. Development of LCMs in its own right (alongside LCY) was not set out clearly as an important operational objective until the Local Currency and Local Capital Markets Initiative (LC2) was launched in 2010. The initiative's stated objective was to achieve more efficient and self-sustaining financial intermediation in the Bank's countries of operations through broader use of LCY and the development of LCM. In 2013 the initiative was redesignated as the LC2 strategy and confirmed as one of the Bank's three strategic initiatives (along with Green Economy Transition and Early Transition Countries).

This evaluation provides an assessment of Bank activities in support of LCM development under the LC2 initiative and strategy.

## 1.2. Scope

The evaluation concentrates on strategy and operations from 2012 to 2015 in relation to LCM development. It does not cover LCY lending, except insofar as it affected LCMs. A strong link has been seen by the Bank between operations supporting LCY and local banking systems on one side, and LCM development on the other, and this is acknowledged. However, the many LCY loans to corporates have not shaped LCM development more broadly and have therefore been excluded to ensure focused analysis. All LC2-related technical cooperation (TC) and policy dialogue activities have been covered in this study. Until 2014 the Bank did not disaggregate LCM-supportive projects from LCY projects for the purposes of classification and record-keeping, and thus did not track LCM in its own right. Data for 2012-13

### Box 1. Key definitions

**Capital market** is a market for the buying and selling of long-term security instruments, such as stocks, bonds or derivatives. It enables issuers (supply side) and investors (demand side) to trade such instruments within a certain market infrastructure (Independent Evaluation Group, World Bank Group, 2016).

The Bank (LC2 team) defines **LCM-supportive transactions** as (LC2 team, 2015):

"Local capital market investments (as opposed to local currency financing) may be denominated in local or foreign currency but must fall into one of the following three categories (referred to here as LCM-supportive transactions):

- investments in bonds, securitisations, repos or derivative frameworks
- equity investments in listed companies (including Initial Public Offerings and pre-Initial Public Offerings investments), capital market infrastructure (stock exchanges, depositories, etc.) or domestic institutional investors focusing long term (life insurance companies and pension funds, but not banks or non-life insurance companies) or
- investments in deposit insurance guarantee schemes."

LC2-supportive investments were compiled manually by the LC2 team.

Bank LCM-supportive activities encompass:

- investments in local securities (bonds and stocks of listed companies), market infrastructure (stock exchanges) and institutional investors
- policy dialogue and TC assistance to develop a favourable environment for capital market-related activity
- the EBRD Treasury bond issuance in LCY on local and international markets
- advice and support for LCM and derivative markets
- derivatives trading in LCY and local markets.

The LC2 strategy sets out five **focus themes** on which the EBRD would concentrate:

- improving the legal and regulatory environment to support capital markets
- developing financial market infrastructure
- promoting a more efficient transaction environment and expanding the product range
- developing the institutional investor base
- building stable and sustainable macroeconomic policy frameworks.

The first three of these have been the primary focus of the Bank's work and are the primary focus of this evaluation. Activities related to the macro environment (extremely broadly drawn in the strategy and therefore largely non-evaluable) are not reviewed here; examination of work related to development of the institutional investor base was limited to desk reviews of project documentation.

The review first provides historical background to the current approach to LCM development, and how it led to the formulation of the 2013 LC2 strategy. It comments on the strategy's objectives, relevance and evaluability, and identifies the links between country/sector strategies, the LC2 strategy and country needs and legal assessments prepared under the initiative. It reviews how the Bank organised itself to implement the initiative. The key part of the review examines the Bank's main LCM development activities – investments, policy dialogue, TCs, Treasury operations – and seeks to identify specific objectives and broader outcomes that may be attributed to LCM projects. Cooperation with other IFIs is briefly examined. Finally, the review summarises the results of numerous case studies and sample project evaluations, and analyses LCM transition gaps and indicator changes during the evaluation period.

## 1.3. Objectives and approach

The evaluation centres on the following questions.

- Were the LC2 strategy and its objectives relevant to the requirements of the countries of operations?
- How effectively has the LC2 strategy been implemented?
- What have been the early results of LCM projects and strategy implementation?
- What key issues and lessons may be identified to improve the effectiveness and efficiency of future strategy and operations?

### Box 2. Evaluation approach

- The evaluation relies on internal and external interviews, extensive document review and review of a portfolio of 92 LCM investments and 40 TCs. Eight country strategies (for countries primarily targeted by the Initiative) and four sector strategies were reviewed through the prism of the LC2 strategic objectives.
- For each of the three LC2 focus themes the evaluation team selected one case study and two sample projects (TCs or investments). Case studies were primarily based on a document review, and internal and external stakeholder interviews; findings and recommendations from case studies and sample projects are presented in Annexes 4 and 5.
- Case studies and sample projects were rated for relevance, effectiveness and efficiency, reflecting delivery of outputs and achievement of their targets in respect of LCM development. No other aspects of project performance were assessed. For recently completed or ongoing projects only the potential for achieving results and overall impact was assessed.
- Broader LCM-transition impact indicators and changes to them in all countries of operations between 2012 and 2014/15 were analysed.

**TABLE 1. THE EVALUATION CASE STUDIES AND SAMPLE PROJECTS**

| LC2 focus theme | Case studies | Sample projects |
|---|---|---|
| Improving legal and regulatory environment | Derivatives Law and Regulations Development TC – Ukraine | Covered Bonds Law and Regulations Review TC – Poland<br>Derivatives Law and Regulations Development TC – Morocco |
| Developing financial market infrastructure | South-Eastern Europe Trading Platform (SEE Link) TC – trading platform, integrating smaller stock exchanges in the Balkans (managed by Zagreb Stock Exchange, Croatia) | Bucharest Stock Exchange – Romania (investment)*<br>Moscow Stock Exchange – Russia (investment) |
| Promoting a more efficient transaction environment and expanding the product range | Bucharest Municipal Bond – Romania (investment) | OTE corporate bond (first mid-term post-crisis bond) – Greece<br>KICB corporate bond (TC and investment) – Kyrgyz Republic |

* To ensure geographical diversification, it was originally planned to review the Borsa Istanbul investment as one of the sample projects. However, following events in Turkey in July 2016, it was replaced with the Bucharest Stock Exchange project.

KICB = Kyrgyz Investment and Credit Bank; OTE = Hellenic Telecommunications Organisation S.A.; TC = technical cooperation project.


# 2 Historical background

## Main findings

- Although LCM development was identified at the founding of the EBRD, much of the work over the following 20 years to support this commitment was performed as a core Bank objective mainly by Treasury and OGC Finance as part of their everyday activities, and lacked resources and an overall strategic focus.
- LC2 was launched after the global financial crisis in part to strengthen the Bank's LCM development objectives and operational work, and represented a clear elevation in terms of priority and focus. However, it was loosely organised and lacked clear objectives.
- A dedicated LC2 team was set up in 2012 in order to assemble capacity and establish clearer responsibility. Shortly thereafter Bank Management proposed and the Board approved a formal LC2 strategy, which finally identified LCM development as the initiative's main objective.

LC2 had its roots in the Bank's LCY lending and borrowing programmes. Dating from the early days of EBRD operations these were designed to enable local clients to borrow in LCY in order to mitigate foreign currency exposure risks. Over time it became clear that sustainable LCY financing would require systemic reforms of the financial sector. While issues and challenges around the Bank's LCY approach can be relevant to issues of LCM development, they are not addressed in this evaluation.

Bank engagement in LCM development can be divided into three periods, summarised below.

**1994–2009:** Activity was focused largely on LCY lending and borrowing but accompanied by targeted policy dialogue and legislative changes with direct impact on selected LCMs. These activities were led by the Treasury department, working with OGC Finance, using primarily its own staff resources for policy dialogue and technical assistance. The activities included enabling and liberalising amendments to securities markets laws (Armenia, Romania, Russia, Serbia and Ukraine), derivatives laws (Czech Republic, Hungary, Kazakhstan, Poland, Russia and Slovak Republic), debt market law and regulatory frameworks (Albania and Russia), and repo and foreign exchange laws (Russia, Serbia and Ukraine). The Bank also supported development of local clearing and depository systems in Croatia, Romania and Russia, as well as links between local central security depositories and the international central security depositories. At the end of this period work started on inflation targeting in Armenia, Georgia and Kyrgyz Republic.

Another area of focus was support for creation of money market indices. In Russia development of the first credible and transparent benchmark (MosPrime index) enabled issue of floating-rate bonds, provided a benchmark for the domestic market for bank loans and became a reference for interest rate hedging products. The Bank also supported development of the Rouble Overnight Index Average (RUONIA) in Russia, KievPrime in Ukraine and KazPrime in Kazakhstan, which improved monitoring and analysis and stimulated trading.

The Bank's own LCY domestic market bond issues occurred only in Hungary (starting in 1994), Russia (starting in 2005) and Romania (starting in 2009). The Bank's Russian LCY-bond issue programme was the largest of these – 16 rouble bonds (equivalent to €1.1 billion), with an average maturity of five years. In preparation for its first issue the Bank worked with the Russian government on amending 13 laws and regulations to make such issues possible (see Annex 2 Box 2 for list). In Romania, work in advance of a Bank bond introduced a new floating-rate benchmark, extended the yield curve and was the first to utilise a prospectus approved by the United Kingdom competent authority and passported in Romania in accordance with EU directives to achieve a joint offering in Romania and the UK.

The Treasury also issued a number of Eurobonds denominated in LCY on offshore markets, which are counted by the Bank as LCM supporting. However, no wider market developments were needed for (or accomplished in the context of) these issues; their very

## Box 3. Milestones in Bank approach to LCM development

| | |
|---|---|
| 1991 | Articles of Agreement identify key objectives of LCM development |
| 1994 | First Treasury bond in LCY issued on Hungarian LCM |
| 1999 | Local Currency Borrowing Programme launched |
| 2006 | *Transition Report* (EBRD, 2006) highlights risks from foreign currency mortgages and need for LCMs |
| Oct 2006 | "Local Currency Operations of EBRD" (Bank information memorandum) argues for more LCY lending and deepening LCMs through more Treasury bond issuance |
| Jan 2009 | Vienna Initiative |
| Mar 2010 | The EBRD leads Vienna Initiative Working Group on Local Currency and Capital Markets |
| 2010 | *Transition Report* (EBRD, 2010) discusses need for LCM development |
| Apr 2010 | Board presentation of LC2; Working Group on LC2 established |
| Jun 2010 | LC2 officially launched at the EBRD Annual General Meeting |
| Dec 2010 | Early Transition Countries Local Currency Loan Programme established to facilitate LCY lending |
| Mar 2011 | Vienna Initiative Working Group sets out role of IFIs in LCM development; the EBRD was the main author |
| Dec 2011 | LC2 Working Group updates the Board on initiative activities and work plan for 2012 |
| Mar 2012 | TC framework for LC2 activities approved |
| Dec 2012 | LC2 team established |
| 2013 | LC2 integrated into Capital Resources Review 4, defined as one of three strategic initiatives |
| Nov 2013 | LC2 strategy presented to Board and approved |

indirect impact on LCMs was likely limited to forging linkages between local and international depository systems, which may subsequently have helped attract international investors to the LCMs (as securities were now cleared under English law). However, the wider growth observed in international portfolio flows was almost certainly driven mainly by selected countries' accession to the EU.

Separate work by the EBRD Legal Transition Team on a model investor protection law and corporate governance law improvements may have had a favourable effect on LCMs in certain countries.

Targeted interventions during this period (legislation, pioneering bond issues, new indices) likely had their targeted positive outcomes. However, larger impacts were limited to three markets where LCY bonds were issued (Romania, Russia and to some extent Hungary).

**2010–12:** During this period the Bank strengthened its conceptual approach to LCM development (alongside LCY promotion). LC2 was launched in 2010, following work under the Vienna Plus Initiative, with a double objective of promoting LCY and LCM development. Implementation was to be loosely coordinated by a working group comprising representatives from four Bank departments – Treasury, Banking, OGC/Legal Transition Team and the Office of the Chief Economist. The initiative certainly extended the potential scope of Bank engagement in LCMs, especially in relation to market infrastructure and the equity markets. However, it did not constitute a cohesive strategy for LCMs. The working group concentrated on preparing LCM country needs and legal assessments, which identified specific institutional and legal reforms, investments needed for selected countries to develop their capital markets, and recommendations (Annex 11). Missions to 10 countries were undertaken jointly with International Monetary Fund (IMF) and World Bank staff to underpin these assessments. A dedicated LC2 team was set up at the end of 2012 to coordinate the implementation of the initiative.

**From 2013:** In 2013 LC2 was integrated into Credit Resource Review 4 and designated as one of the Bank's three key strategic initiatives, and the LC2 strategy was launched at the end of that year. The strategy clearly defined LCM development (alongside the promotion of LCY) as the initiative's main objective. The following sections assess key attributes of the strategy.

# 3

# LC2 strategy

## Main findings

- LC2 and its strategy intended to support more systematic and ambitious Bank engagement in LCM development in view of the serious disruptions caused by the global financial crisis as well as analytical work confirming that LCMs in Bank countries of operations were lagging significantly.
- The strategy was a useful step towards consolidating the various separate elements that constituted LC2. Five priority themes for Bank operations were linked to the LCM development priorities identified in earlier country-level needs and legal assessments.
- While the strategy broadly identified appropriate areas of focus, it was strongly cast in activity- and product-driven terms and set objectives only very broadly. Quantitative and qualitative outcomes at the level of main target countries were not well defined. Only two of four performance indicators were relevant for LCM development support, and they lacked well-specified targets and objectives.
- Overall evaluability of the strategy was poor.
- A separate document dedicated to capital market infrastructure was also produced and can be seen as the LC2 sub-strategy. It better articulated intentions related specifically to market infrastructure development and helped shape subsequent interventions.

## 3.1. Objectives and relevance of the strategy

Approval of the LC2 strategy in November 2013 was a milestone in the Bank's approach to LCM development. Its stated strategic objective is "to achieve more efficient and self-sustaining financial intermediation in country of operations, through broader use of LCY and the development of LCMs, thereby contributing to economic progress and fostering more stable financial environment". A number of operational objectives are identified and activity-based measures of success such as number of LCM transactions are presented under "Objectives" and "Scorecard Parameters". However, intended results are not articulated.

The strategy indicated that the Bank would focus initially on developing legal and regulatory frameworks to help stimulate money and repo markets in early transition countries (ETCs), and covered bonds and derivatives in more advanced countries, such as Poland, Russia and Turkey. These frameworks would be developed using policy dialogue and TCs, primarily for policy changes and regulatory capacity development. The Bank's focus would then shift to supporting market infrastructure, such as payment systems and central counterparties. Subsequently the focus would move to development of the institutional base, particularly pension funds and insurance companies, important sources of long-term capital. Finally, the Bank would promote a more efficient transaction environment and expand its product range.

The strategy proposed a monitoring framework based on tracking improvements in LCM development gaps reported in the "Assessments of Transition Challenges" on the EBRD institutional scorecard. These indicators comprise: (i) number of LCY-denominated debt investments in total Bank operations; (ii) number of LC2-related equity investments in total Bank operations; (iii) number of foreign-currency-denominated transactions that contribute to the development of capital markets in countries of operations, including investments in bonds, repos and asset-backed securities; and (iv) a qualitative review of the implementation of country assessment recommendations through policy dialogue and TC.

While these activity-based indicators are of value, the strategy was vague on the results it intended to achieve, and mis-specified them in important respects. For example, the results framework incorrectly presents activity inputs for each theme (that is, policy dialogue, technical assistance, capacity-building, investments) as outputs. Outcomes are presented in very generic terms such as "improved regulatory framework" and "new instruments traded"; impacts are treated similarly, such as "larger market size" and "improved market liquidity". In no case are baselines presented, making an evidence-based ex-post assessment impossible. That said, the concept of results frameworks was new to the EBRD in 2013 and its implementation has likely improved appreciably since then.

In October 2015 the LC2 team issued an internal paper, "Capital Market Infrastructure – Status, Trends and LC2 Approach", which discusses the role, status of development and challenges related to capital market infrastructure in the Bank's countries of operations. In particular, it covers stock exchanges, central counterparties, central security depositories, trade repositories, trading platforms, rating agencies and crowdfunding platforms. It also provides an indication of the LC2 team's specific plans to support development of capital market infrastructure, which was to be focused on regional cooperation, consolidation and integration. The first project reflecting this approach has been completed – the South-Eastern Europe Trading Platform (SEE Link) in the Western Balkans, which supported the creation of a regional trading platform (see case study in Annex 4 and brief description in section 6.2). Subsequently, the LC2 team also launched TCs aiming to strengthen market infrastructure in Egypt (Central Securities Deposit), Macedonia (Central Securities Deposit) and Poland (benchmarking of the stock exchange), all of which are ongoing. Also, a feasibility study on the establishment of a regional central counterparty clearing house was completed (for more information on these TCs see section 6.2).

## 3.2. Adequacy of the strategy

The strategy was a useful step towards consolidation of the various separate elements that underpinned LC2, including its fuller description of LC2 issues and planned Bank activities. It set five priority themes for Bank operations, which were linked to the LCM development priorities identified in country-level needs and legal assessments.

However, the strategy was overly activity-driven and insufficiently results-driven. Its results framework lacked clarity as its output parameters were incorrectly defined (see section 3.1 above), while outcomes were too general to represent a meaningful basis for the assessment of the initiative's results. The strategy offered four success/monitoring indicators for the initiative's performance, two of which could be relevant for measuring results in LCM development support. But without quantitative targets and well-defined qualitative objectives this assessment could not be completed, indicating that its evaluability was poor. Instead of attempting a single results framework for the whole initiative, country-specific LCM development results frameworks could have been prepared for three or four key countries. This would have provided better guidance and clarity on the Bank's intended actions and, most importantly, the results it wanted to achieve.

The internal paper, "Capital Market Infrastructure – Status, Trends and LC2 Approach", articulating the LC2 team's approach to market infrastructure development was a useful supplement to the strategy; however, it covered only a single area of activities.


# 4

# Links with country and sector strategies

This section discusses the links between the LC2 strategy and sector and country strategies, as well as their links to country needs and legal assessments.

## Main findings

- LCMs featured strongly only in the Financial Institutions Sector Strategy; it was either absent from or mentioned only in passing in all other sector strategies.
- Treatment of LCMs in country strategies was uneven. While set as a strategic objective, albeit in general terms, in some countries (Morocco, Poland, Romania, Turkey) no mention was made in others (Greece, Kyrgyz Republic). Neither needs assessments nor country strategies provide much clarity on specific results the Bank wants to achieve and how. The country assessments do appear to have improved over time; in general, however, they do not reflect the basic approach of the LC2 strategy.
- Country strategies rarely reflect the LCM development priorities identified in country needs assessments.
- Country strategies and needs assessments were used primarily as tools for initiating policy dialogue, but played only a limited role in the identification and implementation of the LCM projects. Recommendations from legal assessments on the other hand seem to have been used more often to guide interventions.
- There is little evidence that interventions were sequenced on the basis of the analysis of country circumstances presented in its strategy (for example, a TC was done for Ukrainian derivatives while its money market was still underdeveloped).
- Many needs and legal assessments are now outdated and no longer relevant.

## 4.1. Links to sector strategies

The LC2 strategy expected the financial sector would take a leading role. The Bank's Financial Sector Strategy was the only sector strategy that prioritised and elaborated on LCM operations. However, the key target countries and regions it identified for the Bank's LCM development activities (Bulgaria, Central Europe and the Baltic states, Romania and Turkey) were only partially in line with LC2 team priorities demonstrated by the choice of countries for which LC2 needs and legal assessments were completed. Some countries or regions referred to in the Financial Sector Strategy as targets for LCM development (for example, the Baltic states and Bulgaria) are not mentioned in the LC2 strategy.

The **Financial Sector** Strategy of 2010 prioritised crisis response (recapitalisation of banks), with LCM development a lower priority. The current Financial Sector Strategy (2016) reinforces the objectives of recapitalisation of banks and developing non-bank financial institutions, such as "exchanges and pension funds that support the operations of the capital markets". However, it covers LCM development more effectively and in more detail than its predecessor. It highlights the importance of converting some of the existing national central counterparty clearing houses into regional clearing hubs and ensuring third-party recognition by other counterparty clearing houses, such as Euroclear. The Financial Sector Strategy pointed to a "de-mutualisation" of a number of stock exchanges in the countries of operations, which could enable the entry of a strategic investor. The importance of developing legal frameworks for covered bonds in countries such as Croatia and Poland is highlighted. The strategy elaborates on linkages with country strategies and notes that in the Bulgaria, Central Europe and the Baltic states, Romania and Turkey the Bank would concentrate on the development of LCM and LCY lending through financing and policy dialogue.

The **Transport Sector** Strategy of 2013 has a paragraph on LCMs in its "Financing approach" section, noting the need for new ways to raise private finance for transport, including through both domestic and international capital markets. The strategy confirmed that the Bank would continue promoting financial products such as bonds. The **Municipal and Environmental Infrastructure Sector** Strategy

(2012) stresses the need to diversify funding sources through increased private sector participation (public–private partnerships and capital markets). The 2013 **Energy Sector** Strategy does not mention LCMs (or even LC2).

## 4.2. Links with country strategies and diagnostics

The LC2 strategy envisaged that country diagnostics (needs and legal assessments) would play a key role in developing the Bank's LCM strategies at the country level. Table 2 lists the countries where diagnostics were prepared and the EBRD's capital market transition indicators for 2012 and 2016 (indicators for the remaining countries of operation are presented in Annex 9 and analysed in section 7.2). Conditions in the capital markets have deteriorated in eight of the 16 countries where needs assessments were prepared, and improved in only two – Morocco and Turkey. However, overall conditions have been very difficult across many of the countries of operations' capital markets since LC2 was initiated, so this finding should be used with care.

Links between the LC2 strategy and six country needs assessments and country strategies are summarised below.

**Romania:** The LC2 needs assessment (2012) recommended developing an interbank repo market, a covered bond market and supporting pension funds. The current 2015 country strategy recommends: "Broadening access to finance by inducing lending and developing capital markets". It also elaborates on what the Bank will do under LC2 (subscriptions to corporate bonds; structured instruments and asset-backed securitisations, including mortgage-covered bonds, particularly in LCY; encourage secondary market through support to initial public offerings and

**TABLE 2: LCM COUNTRY-LEVEL TRANSITION INDICATORS FOR COUNTRIES FOR WHICH EARLY NEEDS AND LEGAL ASSESSMENTS WERE PREPARED**

| Country | Region | ETC[i] | LC2 assessment | Transition impact indicator for capital market development | | |
|---|---|---|---|---|---|---|
| | | | | 2012[ii] | 2016[ii] | Change[iii] |
| Kazakhstan | Central Asia | N | 2012 | 3 | 2 | < |
| Kyrgyz Republic | | Y | 2012 | 2 | 2– | < |
| Mongolia | | Y | 2012 | 2+ | 2– | < |
| Tajikistan | | Y | 2011 | 1 | 1 | = |
| Hungary | Central Europe & Baltic states | N | 2011 | 3+ | 3+ | = |
| Poland | | N | 2011 | 4– | 4– | = |
| Armenia | Eastern Europe & the Caucasus | Y | 2012 | 2 | 2 | = |
| Georgia | | Y | 2012 | 2– | 2– | = |
| Moldova | | Y | 2011 | 2+ | 2 | < |
| Ukraine | | N | 2011 | 3– | 2 | < |
| Romania | South-Eastern Europe | N | 2012 | 3 | 3– | < |
| Serbia | | N | 2013 | 3– | 2 | < |
| Turkey | | N | 2012 | 4– | 4 | > |
| Jordan | Southern & Eastern Mediterranean | N | 2012 | 3– | 2 | < |
| Morocco | | N | 2013 | 3– | 3 | > |
| Tunisia | | N | 2012 | 2+ | 2+ | = |

Source: Transition Reports 2012–16 (EBRD, 2012; 2013b; 2014; 2015).

Notes:
i Early transition country: N = no; Y = yes.
ii Low transition impact = 1 (centrally planned economy); High transition impact = 4+ (advanced economy).
iii < decreased; > increased; = unchanged.

the Bucharest Stock Exchange). While this specified the Bank's LCM development objectives for Romania reasonably well, it was not based on the LC2 needs assessment recommendations.

**Kyrgyz Republic:** The initial needs assessment (2012) provided eight recommendations. However, they were extremely general, relying on actions such as "build LCM by harmonising strategies" (unspecified), "increase capacity to forecast inflation", "EBRD to provide advice on corporate bond issues" and "strengthen cooperation across agencies (National Bank, regulator, Ministry of Finance)". The 2015 country strategy for the Kyrgyz Republic did not refer to the LC2 strategy or the assessment, noting only that "capital markets were very immature, creating risks for LCY projects".

**Poland:** The needs assessment (updated in 2013) was also formulated in general terms, such as "Reduce maturity mismatches in the banking sector". Its recommendations generally mapped well onto the LC2 focus themes, but no qualitative or quantitative targets were set. The 2013 Poland Country Strategy stated that "assisting in the development of sustainable financial sector and capital market" was one of three strategic priorities (along with energy efficiency and private sector development). The strategy indicated the Bank had been developing the LCMs for some time in Poland, although with limited success. Despite this the strategy stresses that the Bank would "pursue opportunities to accelerate the development of the debt capital market through subscription to bank and corporate bonds, structured instruments and asset-backed securitisation; support development of alternative long-term funding instruments, mobilising a wider investor base – particularly in view of an expected diminished role of private pension funds – and ensuring increased market liquidity". Policy dialogue and TC was to be considered for covered bonds, for use of collateralised transactions and for market-based funding of mortgage instruments. There was a better synergy with the needs assessments than in the case of Romania. However, because of the general nature of its recommendations and statements, the country strategy established only relatively weak links with the more precise recommendations of the country needs assessment.

**Ukraine:** The needs assessment of 2011 lists seven LCM-related areas for policy focus: enhancing macroeconomic stability, enhancing monetary policy, foreign exchange market liberalisation, money market development, strengthening the liability base of the banking sector, improving the sustainability of the pension sector and resolving non-performing loans. These recommendations were elaborated in very general qualitative terms. The 2011 Ukraine Country Strategy notes in its summary of the Bank's strategic directions that "in cooperation with other IFIs, the Bank will help the authorities strengthen the role of private capital in the banking sector". No further details are provided.

**Turkey:** The 2012 country diagnostic presented a reasonably concise set of recommendations, including strengthening the interbank money market and the credibility of the reference rates, developing the interest rate swaps market and evaluating pension investment policies and regulations. The Country Strategy for Turkey (2015) refers to "deepening capital and local currency money markets" as one of the Bank's objectives. It states that "through investments in the bond and equity markets, the Bank will seek to demonstrate the benefits of capital market financing". This statement falls far short of the recommendations proposed in the LC2 needs assessment, and is not reinforced by any specific targets.

**Morocco:** The most recent LC2 assessment (2013; Deauville Partnership, 2015) contains much more detailed analysis than previous country assessments and more than 30 reasonably concise recommendations. Morocco's 2015 country strategy contains a reference to LCM development, saying that the EBRD would follow a sequential approach in advancing capital market development, focusing initially on supporting equity and bond issuances with demonstration effects to deepen market liquidity. The Bank will also engage with relevant stakeholders on improving capital market regulation, financial products and market infrastructure, recognising that improvements in those areas take time and that liquid markets are a prerequisite for success. The Bank will also work with the Moroccan authorities on the further commercialisation of state-owned banks and support the insurance sector with the view to develop long-term investors.

This statement actually mirrors the LC2 focus themes in broad terms (such as "prioritise legislative and regulatory changes in connection with enhancing the legal framework governing debt securities and other financial instruments, including a new law for stock exchange, Islamic finance law, and new law for financial services"), although it is a very general statement of intent.

It is clear that some country needs assessments from 2011 to 2013 are outdated. Officials in Morocco, Poland and Romania indicated that many of the priorities presented in these assessments had already been addressed, and new priorities had emerged. The Bank is aware of these issues. In 2015-16 it updated one assessment (for Ukraine) and issued a new one for Croatia, but more updates are needed. In the longer term, the LC2 team might consider introducing a more systematic approach to updating these assessments (for example, setting up a TC framework for biannual updates of all needs assessments for the main target countries). The Bank should also incorporate LC2 more systematically into country strategies. Newer strategies better reflect the LC2 strategy's objectives and further improvement is expected as they increasingly incorporate appropriate results frameworks.

# 5 Organisation and resources

## Main findings

- LC2 organisation and resourcing is built on previous, mostly ad hoc, arrangements. With the strategy came selected new elements of structure and institutional coordination to provide greater support and profile.
- However, it has several important weaknesses. Despite creation of the designated LC2 team, sector and regional responsibilities and reporting lines remain largely unchanged; there is lack of clarity on the authorities and processes by which strategic and operational choices are made within LC2.
- The LC2 steering committee has provided little strategic guidance; coordination occurs informally outside the committee, whose quarterly meetings appear limited mostly to reporting.
- No strategic resourcing plan has been developed.
- A very small initial TC budget (€1.3 million) has been supplemented by ad hoc project-specific funding, but this is insufficient to meet priorities identified in the strategy or country needs assessments. Donor funding for LCMs has been difficult to obtain.
- About one-third of staff are funded externally as secondments or through short-term contracts; staff turnover is very high.
- LC2 'liaison' tasks were assigned to resident office staff to bolster the initiative's profile and capacity. In some cases, valuable contributions have been made. However, pre-existing work programmes and reporting lines remain unchanged; LC2 responsibilities appear fully incremental.

## 5.1. Organisation

Until the LC2 team was created in 2012, the 2010 initiative was informally coordinated by the working group consisting of representatives from four Bank departments (the Treasury, the Office of the Chief Economist [now Economics Policy and Governance], Legal Transition Team/OGC and Banking). This set-up lacked a focal point, while the demands of the initiative turned out to be heavier than expected and interfered with these departments' other responsibilities. This organisational structure is similar to that of other Bank initiatives (e.g. Early Transition Countries, Sustainable Energy/Green Economy), namely it is largely horizontal with pre-existing teams and departments remaining in place and intended to cooperate horizontally and mostly informally.

The LC2 team was nominally created to act as the initiative's focal point, coordinating Bank-wide LCY and LCM development-related interventions, leading general policy dialogue and undertaking LC2-focused TC projects. It takes strategic and operational decisions in respect of TCs and certain areas of policy dialogue and is responsible for coordinating the Bank's efforts in those fields. However, the positioning and responsibilities of the other key Bank teams essential to delivering on the Initiative remain largely unchanged. The Banking Department is solely tasked with identifying, preparing and implementing the Bank's LCM investments. The Treasury remains responsible for policy dialogue in relation to borrowing, lending, hedging and managing liquidity in LCY. The OGC Finance supports the Treasury in this work. Each team reports to its respective managing director, vice president or chief.

Until November 2016 the LC2 team reported to the Vice President Finance. Since then the LC2 team has been part of the new Services Group under the Vice Presidency Policy and Partnerships. Some interviewees hope this arrangement will help the team sharpen its focus on policy dialogue and systemic reforms and strengthen links between team activities and country strategies. It is still too early to assess any changes.

The LC2 team has been subject to direct oversight by the **LC2 steering committee**, chaired by Vice

President Finance/Chief Finance Oficer and comprising the LC2 team director and senior members from Economics Policy and Governance, OGC, Treasury and Banking. The committee met quarterly to provide guidance on the initiative's strategic direction and to ensure cross-departmental coordination within the EBRD. However, some members see the committee mainly as a platform for one-way reporting, with most internal coordination done informally. For example, the LC2 team meets quarterly with Banking to agree on future priorities and activities. The Evaluation Department (EvD) understands that the role of the committee is under discussion.

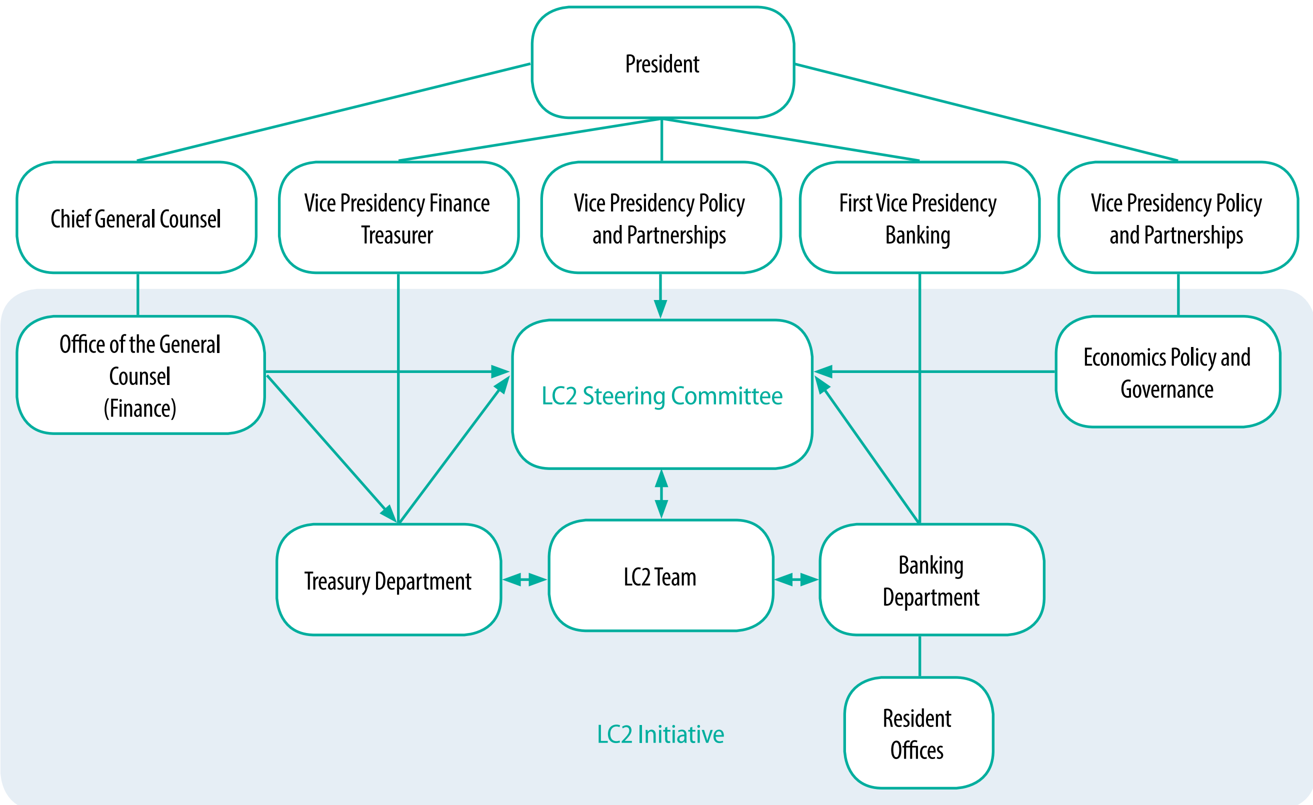
The **LC2 team** is organised around the LCM products, corresponding to the initiative's five focus themes; each is assigned to a primary and a secondary LC2 team manager mainly responsible for its development and implementation. The team is supported by junior colleagues and consultants. In addition, primary and secondary region/country responsibility for each of the EBRD's regions and five LC2 focus countries is assigned to an LC2 team member. In practice this division of labour has been generally followed, although the structure is flexible and different managers have sometimes been deployed to work on projects outside their specialisation. There are also 34 designated LC2 liaison officers at the resident offices.

One apparent strength of the current set-up is that it promotes personal responsibility for specific tasks and helps build relationships with key clients. Interviewees cited the team's capacity to institute and manage technical assistance, utilising its own expertise but also often drawing on the expertise of other departments from across the Bank.

The **Banking Department** was mandated to invest in LCMs primarily to increase their depth and liquidity. It works independently, but in principle coordinates or consults with the LC2 team on LCM-related issues. Within Banking, the financial institutions group, particularly the financial institutions Insurance and Financial Services team, is responsible for financing LCM-enhancing projects, such as institutional investors and LCM infrastructure (stock exchanges). The financial institutions Insurance and Financial Services team works most extensively with the LC2 team, compared with other Bank teams. According to both teams the coordination of activities functions well, with the LC2 team providing expert advice and leading the policy dialogue and the financial institutions Insurance and Financial Services team focusing on generating, processing and implementing investment transactions.

With few LCM-supportive investments in non-financial institution sectors, cooperation with these other

**FIGURE 1: LC2 ORGANOGRAM**



Bank teams relates mainly to LCY financing. The main reason for this is lack of demand for corporate bonds in most sectors and countries, often because the cost of such financing is higher than that of a loan. Only the Transport team has developed a larger portfolio classified as 'LCM-supportive'; however, this classification is questionable in some cases (see section 6.1). Other Banking department teams brought only one or two LCM-supportive projects during the evaluation period.

The **Treasury Department** has historically played an important role in efforts to promote LCMs, viewing their development as one of its tasks. It led and coordinated early efforts and provided support for creation of LC2 and its team. When the LC2 team was established, this coordinating role was transferred to the new team and the Treasury focused on supporting LCMs principally through issue of LCY bonds, creation of money market indices, and the application of foreign exchange and derivative instruments. Treasury is an active participant in policy dialogue, focused mainly on removing barriers to bond issues and creating an enabling environment through activities such as revising regulations and developing master agreements to issue or invest in capital market instruments.

Three different OGC teams have been involved in LC2 and in different ways at different times. The Legal Transition team was involved in policy dialogue and legal and regulatory reform during the early stage of the Initiative through a dedicated lawyer. After the LC2 team was established the lawyer was seconded there with dual reporting; however, reporting lines remained unclear and the position was finally transferred to the LC2 team. OGC Finance advises on Treasury operations, including support to legislative changes to enable the Bank's bonds issues; OGC Banking focuses on transactions. Economics Policy and Governance (then the Office of the Chief Economist) has been involved in regional policy dialogue on issues such as dollarisation and capital market development, and contributes to country strategies. The LC2 team and the Office of the Chief Economist, Economics Policy and Governance worked together to prepare initial country assessments and develop methodology to incentivise bankers to develop LCY transactions by boosting their transition ratings. The LC2 team also provides Economics Policy and Governance with input into the capital market development aspects of deals as part of the weekly operations committee review process, contributing to the structure and focus of investments and enhancing the capital market impact.

## 5.2. Resources

LC2 team senior management has been broadly stable across a period of substantial change. Team staffing has grown from nine initially to 15 at year-end 2016. Of these about one-third were seconded or short-term consultants; secondees are financed externally by member governments and often sourced from countries of operations. While their contributions have been valued, the relatively short-term nature of their engagement prevents longer-term planning and stronger commitment to the team and its objectives.

The LC2 team identified 34 LC2 liaison officers based in the resident offices generally expected to spend up to 10 per cent of their time on LC2 issues. Their tasks are to monitor LCM issues in their countries, serve as the first contact for potential clients, participate in Banking projects with an LCM dimension, and support TCs and to some extent policy dialogue conducted by the LC2 team in their countries. Some of the liaison officers are country directors or office heads, while others are senior or more junior bankers. All are tasked with other duties and report to managing directors, country directors or office heads. The more senior LC2 liaison officers have been involved in LCM policy dialogue in some countries, and there are cases of active engagement by liaison officers elsewhere. Involvement has been greatest where LC2 is an identified strategic objective for the Bank, another reason for more clarity on links between LC2 and country strategies. The LC2 team provides no formal input into annual appraisals of LC2 liaison officers.

The LC2 team was initially allocated a relatively small TC budget of €1.3 million. This was sourced from the Bank's Special Shareholders Fund (SSF), because donor interest in LC2, especially LCMs, has been relatively weak. The amount of €1.3 million was established on the basis of the availability of funds and on the estimates of how much the LC2 team could reasonably use over three years. However, these funds quickly turned out to be insufficient. The LC2 team invested considerable time and effort in raising supplementary TC funds but was only partially successful, obtaining funds to work primarily in ETCs and the southern and eastern Mediterranean region from Japan, Switzerland and the USA. Its core TC budget was supplemented by new contributions from the SSF, with €4 million during 2013-14 allocated for "Building stable financial sectors, local currency and financial institutions". It is estimated that the LC2 team utilised about 70-80 per cent of this allocation (with the rest utilised by the financial institutions team). The team also obtained €4.3 million from the SSF in 2015-16.

The LC2 team also tapped into other TC funds allocated for specific tasks in specific regions or countries – the Middle East and North Africa Transition Fund, Early Transition Countries Fund and South-Eastern Mediterranean Cooperation Fund. One TC (Central Securities Deposit development in Egypt) received matching contributions from the African Development Bank. In total, by the end of 2015 the initiative had attracted about €15 million, while the team is currently (first quarter 2017) in the process of requesting an additional €7-8 million to implement planned TCs. The main sources of future TC funds will probably be the SSF and the EU's Structured Reforms Service. US foundations (Gates and Open Society foundations) are also being targeted.

LC2 also relied on the SSF for non-TC grant funds for the Small and Medium Enterprise Local Currency Risk Sharing Fund, which partially guarantees the foreign exchange risks of the Bank's LCY transactions. This fund attracted over €20 million from the SSF, €2.6 million from Japan and contributions from the Republic of Korea and Taiwan. The EvD notes that this fund mainly supports LCY operations and only indirectly supports LCM development. The LC2 team believes that most of the donors do not fully appreciate the benefits of LCM development, associating it with speculative behaviour, thus the difficulty in raising funds. This perception indicates that the initiative could benefit from a targeted campaign to increase donor awareness of the benefits of LCM development.

# 6

# Review of key LC2 operations

This section reviews outputs and emerging outcomes of the Bank's three LCM development activities: investments, technical assistance and policy dialogue, and Treasury operations. It also reviews cooperation with other international organisations on LCM issues.

## 6.1. LCM investment

### Main findings

- The effectiveness of the Bank's LCM-supportive investments is assessed overall as mixed.
- Concentration of investments in a handful of advanced countries reflects a more advantageous, LCM-supportive cost structure and higher prioritisation of LCM work by the Bank.
- Investments added to LCM capitalisation and improved liquidity in key target markets such as Romania and Poland, but were less effective elsewhere. Longer maturities and creation of benchmark yield curves are observed in some cases, but there is no evidence of the extension of average bond maturities as a result of the Bank's investments.
- Almost a quarter of investments classified as LCM-supportive were in Eurobonds issued in non-countries of operations markets or privately placed; there is no evidence of direct impact on LCMs, and the LCM classification of these transactions is questionable.
- There were clearer LCM effects from investments into four stock exchanges, which benefited from improved corporate governance and Bank-supplied expertise.
- Very few (only three) investments supported institutional investors (life insurance companies only); there were no investments in pension funds, with reversal of pension reforms in many countries of operation perhaps a contributing factor.
- Few investments provided metrics by which to assess effectiveness.

The Bank's most frequently set LCM development objectives for its investments were:

- 'deepening the market' (boosting capitalisation) by adding to the number and volume of corporate bond or stock issues
- extending bond maturities or building a reference pricing benchmark (yield curve) for bonds
- demonstrating new ways of financing or diversifying investment instruments
- attracting institutional investors or broadening the base of investors into LCM
- demonstrating confidence in the market (mostly post-crisis)
- supporting LCM infrastructure (stock exchanges).

Country of operations interlocutors most frequently cited the limited number, volume and diversity of stock and bond listings (and short bond maturities) as the main obstacle to LCM development. Lack of critical mass (in terms of larger market capitalisation) and low liquidity (trading turnover) deterred foreign, particularly institutional, investors from LCMs. Their presence could in turn fuel market development, encouraging new issuers and investors (a virtuous circle). In EvD's view the relevance of a particular objective depended on the specific market and the financing instrument. In some cases, it was weak – for instance, in 2011 the ratios of market capitalisation to gross domestic product (GDP) of the stock markets in Moscow (38 per cent), Warsaw (26 per cent) and Istanbul (25 per cent) were not far from that of Frankfurt (31 per cent), although they subsequently deteriorated (see Table 7 in section 7.2). Therefore, it could be argued that the Bank's equity investments into these markets were not of critical importance. However, the corporate bond markets of the Bank's main target countries were considerably less developed (in terms of the value of outstanding bonds to GDP) than those in more developed countries, for example about 4 per cent in Poland or Turkey and non-existent in most other countries of operation, compared with 140 per cent in Germany or 21 per cent in the Czech Republic. The Bank invested 51 per cent of its total LCM portfolio into corporate bonds and 43 per cent into listed equity/initial public offerings (the remainder were swap transactions). The former were made mainly in more advanced countries, while equity investments occurred in all countries (with a large part in Russia – see Annex 1 for more details). This confirms that the relevance of the majority of the Bank's LCM investments was relatively strong as they targeted underdeveloped sectors of the markets.

The **number and volume** of investments was to play a key role in 'deepening the markets' by building a critical mass of listed and liquid securities. Most of the Bank's LCM projects did not offer any metrics to verify the extent to which the Bank's investments would actually impact the market (for example, by how much, in percentage terms, the proposed transaction would add to an LCM's capitalisation or increase maturity or market turnover). Therefore, it would be difficult to measure the contribution of the Bank's individual projects to the increase (if any) of the LCM's 'depth and liquidity'. However, based on the aggregation of the Bank's investment volume at the country level, the EvD estimates that the impact of such investments on the capitalisation and liquidity of any particular stock market was marginal. As Table 3 shows, the Bank's share in the new stock issues in the Bank's main target countries was on average slightly above 1 per cent (although it increases to 3 per cent if the Greek market is excluded). The Bank made a stronger impact on the corporate bond markets but only in two countries, Poland and Romania, where it invested into 34 per cent and 14 per cent, respectively, of the volume of all new corporate bonds issued during the evaluation period.

There were two main reasons for the concentration of the Bank's investments (especially in corporate bonds) in more advanced countries:

- the cost of a corporate bond issue being relatively comparable to or even competitive with that of a loan in more advanced countries (Box 4)
- stronger incentives for the EBRD bankers to direct clients to capital market financing over loans; LCM development was generally a more important transition impact attribute in more advanced countries, making them more likely to be approved (although LCM was not a sole source of transition impact in any project reviewed). This led to the creation of the Debt Capital Market Frameworks, first for Poland (€600 million Polish zloty equivalent in aggregate in 2013-15) and then for Turkey (€224 million Turkish lira equivalent at the end of 2015). These included a strong policy dialogue component aimed at creating a new bond index. The former has been fully utilised and contributed greatly to the Bank's building of a substantial bond investment portfolio in Poland (see below); the latter has

## Box 4. Comparative study of transaction and issue costs on LCMs

Some technical assistance focused on specific issues constraining LCMs. A study launched in 2014 confirmed a market view that the cost of issuing and trading securities on the LCMs in most countries of operations was prohibitively high and constituted a major deterrent for issuers and investors. Key findings were:

- only Hungary and Poland showed costs at a level near peers
- approval, listing and trading costs for bonds were highest in Russia and Turkey
- costs related to custody and safekeeping were highest in Georgia and Kazakhstan – over 10 times the costs in Hungary or Poland
- securities issue costs are very high in Jordan and Serbia.

The study helped persuade the Bucharest Stock Exchange (in which the Bank owns a stake) to decrease listing costs by about 30 per cent. It also mobilised the Warsaw Stock Exchange to undertake a Bank-sponsored benchmarking exercise to identify opportunities to further decrease its costs (ongoing). Reportedly, the study also resulted in some countries not covered by it (such as Croatia) looking more closely at their costs, some of which were decreased.

On the other hand, the countries singled out by the study as most in need of cost reform have not yet been targeted by the Bank; this is clearly a missed opportunity.

the potential to follow suit provided the overall investment climate in Turkey improves.

As Table 3 illustrates, the Bank's greatest success in deepening markets was in Romania: Bank investment of €127 million equivalent over 2012-15 represented one-third of total new issue volume. In contrast the aggregate volume of new corporate bond offerings in Poland was 10 times larger than in Romania; so although the Bank invested nearly €0.5 billion equivalent in 15 bonds there, its share of new issues and the overall bond market was much smaller. Interviewees in both countries confirmed that, as the largest investor in corporate bonds, the Bank helped to build a critical mass of corporate bond investments and strongly contributed to the deepening and increase of liquidity in both markets.

The Bank's investments in these two markets were visible because both of them were still relatively small. By comparison, in Greece, which was by far the largest and the most active market among the Bank's main target countries (see Table 3), the Bank's five investments resulted in a market share of only 0.45 per cent and 0.03 per cent for new stock and bond issues, respectively. However, investment in a corporate bond in Greece (Hellenic Telecommunications Organisation S.A., OTE) had other positive impacts as it demonstrated confidence in the market, as the first Greek issue post-crisis; indeed, it was followed by five subsequent corporate bond issues (see Annex 5). Athens resident office bankers, working with the new issuers, confirmed that the OTE's successful issue encouraged other prospective issuers to go ahead with their bonds.

The Bank's investments in other markets were much less frequent. Annex 1 presents an LCM portfolio analysis and this paragraph summarises the key data. During 2012-15 the Bank signed 92 investments classified as LCM-supportive, amounting to €2.8 billion. They accounted on average for 6 per cent of the Bank's total number of projects and 8 per cent of Annual Bank Investments – that is, about €700 million on average per year. A number of LCM investments experienced rapid growth of 50 per cent between 2012 (18) and 2013 (27), and then remained relatively stable, with about 23-24 projects per annum during the next two years. The reason for the drop in LCM-supportive transactions in 2014 was the lack of Board support for further EBRD business in Russia, which accounted for a large proportion of LCM projects. The LCM investments were highly concentrated in five countries – Poland, Romania, Russia, Turkey and recently Greece – all of them more advanced in transition. This was particularly the case in Poland, where investments reached about €730 million, being at least double those in all other countries, except for Turkey. In contrast, there were only four LCM investments in Central Asia, amounting to €50.8 million in aggregate, accounting for 4 per cent of total volume (but with the largest having a questionable impact on LCMs, see below). In terms of sectors, financial institutions dominated the Bank's LCM investments, accounting for 67 per cent of all investments, with 42 per cent of the portfolio invested in banks and 25 per cent in non-bank financial institutions.

LCM-supportive investments in sectors other than financial institutions were infrequent and fragmented. They accounted in aggregate for 33 per cent of the total

**TABLE 3: SHARE OF THE BANK'S INVESTMENTS AS A PERCENTAGE OF THE TOTAL ISSUES ON THE KEY MARKETS (€ MILLIONS)**

| | EBRD investments 2012-15 | | Total issues 2012-15 | | EBRD's share in the total market (%) | |
|---|---|---|---|---|---|---|
| | Equity | Bond | Equity | Bond | Equity | Bond |
| Greece | 250.0 | 50.0 | 56,034.5 | 197,108.8 | 0.45 | 0.03 |
| Poland | 274.4 | 456.6 | 6,097.3 | 3,290.3 | 4.50 | 13.88 |
| Romania | 125.2 | 127.7 | 1,994.0 | 369.9 | 6.28 | 34.52 |
| Turkey | 112.1 | 363.4 | 8,166.9 | 40,472.2 | 1.37 | 0.90 |
| **Total** | **761.7** | **997.7** | **72,292.7** | **241,241.2** | **1.05** | **0.41** |
| Without Greece | 511.7 | 947.7 | 16,258.2 | 44,132.4 | 3.15 | 2.15 |

Sources: World Federation of Exchanges (unpublished) for equities; Bank for International Settlements (unpublished) for bonds (except for Romania – Bucharest Stock Exchange monthly reports).

LCM portfolio volume, with the Transport sector holding nearly 50 per cent share of the non-financial institutions LCM portfolio (14 per cent of total LCM volume but only 6 per cent of projects), mainly due to one large transaction, a €200 million highway bond in the Slovak Republic. However, some investments classified as 'LCM-supportive' (including the large investment in the Slovak Republic) very likely had limited or no impact on LCMs. The Eurobonds in which the Bank invested were issued and listed not on the local exchanges but on western European exchanges; or they were privately placed and not listed/traded at all (Table 4). While these issues raised capital and enabled their beneficiary projects to achieve transition-impact objectives, their impact on LCMs cannot have been more than minimal. The EvD identified 11 such projects in the Bank's LCM-supportive investment portfolio, accounting for €0.66 billion (almost a quarter of the total).

Most of these projects had no LCM development objectives – and in the EvD's view, rightly so. In some cases, the operation leaders confirmed that no LCM impact was expected nor was any observed. The LC2 team explained that they were included in the LCM portfolio because such Eurobonds could provide pricing benchmarks for other issuers. Such issues may also raise awareness among local companies of the possibility of financing through capital (hopefully local) markets, as well as among international investors of the issuer's country of origin and its LCM, which in turn could encourage them to explore opportunities to invest there. This would be a difficult causal claim to demonstrate and the EvD has not found supporting evidence. Of possible relevance might be the Mersin port project in Turkey: following Mersin's bond issue on the Dublin Stock Exchange, several infrastructure bonds were issued on Borsa Istanbul (although a causal link with the Mersin issue cannot be established with the available information).

The municipal and environmental infrastructure team concluded one investment into Bucharest's municipal bond (Annex 4) which added to the **diversity of the investment instruments** as there were no real municipal bonds previously. It was expected to have a demonstration effect in Romania but was not followed by any other Romanian municipality. Zagreb, Croatia issued a similar bond in 2016 (after the evaluation period) with the Bank as an anchor investor; Bucharest confirmed that Zagreb had consulted with them in

**TABLE 4: BANK INVESTMENTS INTO EUROBONDS ISSUED AND LISTED ON WESTERN EUROPEAN STOCK EXCHANGES OR PRIVATELY PLACED AND NOT TRADED**

| Project | Country of the issuer | Sector | Year invested | Bank's investment (million €) | Stock exchange (SE) of issue/listing |
|---|---|---|---|---|---|
| Synthos | Poland | Manufacturing and services | 2015 | 50.0 | Dublin SE |
| PKO Bank | Poland | Financial institutions | 2014 | 35.0 | Luxembourg SE |
| Yasar | Turkey | Agribusiness | 2014 | 33.0 | Dublin SE |
| KZT bond | Kazakhstan | Transport | 2014 | 41.6 | SIX Swiss SE |
| R1 Motorway | Slovak Republic | Transport | 2013 | 200.0 | Luxembourg SE |
| BMCE Bank | Morocco | Financial institutions | 2013 | 43.6 | Luxembourg SE |
| Borets | Russia | Manufacturing and services | 2013 | 58.1 | Dublin SE |
| Mersin port | Turkey | Transport | 2013 | 57.7 | Dublin SE |
| Garantibank | Turkey | Financial institutions | 2013 | 72.6 | Privately placed, not listed |
| Isbank | Turkey | Financial institutions | 2013 | 50.0 | Privately placed, not listed |
| Brunswick Rail | Russia | Transport | 2012 | 19.0 | London SE |
| **Total** | | | | **660.6** | |

Note: KZT = Kazakhstan tenge.

advance, providing some support for the Bucharest bond having had some regional impact.

The Bank's impact on LCM cannot, of course, be measured only in terms of the size of its investments and its share in any particular LCM. In almost all LCM projects the Bank was to play the role of an **anchor investor**, that is attracting other investors, rather than maximising its own investments. The EvD reviewed a sample of the LCM investments and concluded that the Bank played this role relatively well. Interviewees indicated that the signal effect of Bank investment fuelled other investors' interest. In fact, about half of initially planned investments were scaled down when issues were oversubscribed; this is part of the reason why many LCM investments were small (below €10 million). This raises some important questions that the available information cannot resolve. On the one hand a regular need to scale down Bank investments could raise doubt about Bank additionality relative to already available investment capital. On the other, it could be a good illustration of the Bank's intended catalytic and leverage effect. It appears likely that the Bank was additional in most transactions from the perspective of investing in longer-term maturity tranches, while scaling down participation in shorter tranches that attracted other investors. For example, investing in Bucharest municipal bond 10- and 15-year tranches leaving those of 7 and 5 years to other investors; or in the Kazakh KTZ Eurobond's 8-year tranche, scaling down its participation from the €75 million approved to €42 million due to the interest of other investors in the 5-year tranche.

Investments in such tranches were also intended to support the objective of **extending corporate bond maturities** and to create reference benchmark yields for them. However, the EvD did not find evidence that the average corporate bond maturity in Poland (where the Bank was by far most active) increased during the evaluation period. Average maturity increased marginally from 3.3 years in 2013 to 3.8 years in 2014, but then decreased again to 3.3 years in 2015.[1] At the same time, however, there were clear signs that the market was ready to accept longer maturities which the issuers tailored to their needs: some issuers offered longer maturities in 2015, such as the developer Ghelamco (4 years) and Alior Bank (8 years). Nevertheless, as interest rates and coupons have declined, many issuers have prefered shorter maturities and refinancing. Companies such as EGB, Griffin and Polnord issued 2-year bonds in 2014-15. No reliable data on average bond maturities from other (for example, Romanian or Turkish) markets are available.

The Bank's objective was also to **broaden the investor base**, as well as to support (directly) institutional investors. The Bank was only one of many investors in all projects, usually taking between 10 and 30 per cent of an issue. The other private investors usually included local or international commercial banks or investment funds (for example, Erste, ING, Temleton, Unicredito). Moreover, large infrastructure issues, such as the Slovak highway Eurobond, attracted other IFIs, such as the European Investment Bank and KfW. However, there is limited evidence that the Bank supported **investments into institutional investor-type companies**. The Bank's definition of such investors (see Box 1) includes life insurance and pension funds, but excludes investments into non-life insurers and non-pension funds, as they have a shorter investment horizon and therefore less impact on LCM development. The role of institutional investors in the development of the LCM is important because their investments are typically large and have a long-term horizon, adding to the stability of a market. However, the EvD identified only three investees in the Bank's LCM 2012-15 portfolio that were genuine life insurers (PZU Poland, Renaissance Life Ukraine and Sava Slovenia), while no investments into pension funds were identified. The EvD notes that the Bank was more successful in supporting institutional investors, particularly pension funds, in the earlier years. However, the reversal of pension reforms in many countries (such as Hungary, Kazakhstan, Poland) prevented such investments in the latter years. Due to the highly political nature of pension system reforms, the Bank was unable to influence them substantially through its policy dialogue (see section 6.2).

The high concentration of Bank investments in a handful of advanced countries was mainly due to the high costs of bond and stock issues and listings in less advanced countries. During the evaluation period the Bank made only four LCM investments in **early transition countries (ETCs)** – two in Armenia, one in the Kyrgyz Republic and one in Mongolia. The investments in Armenia and Mongolia were into pre-initial public offerings or initial public offerings of mining companies and a bank, while the investment in the Kyrgyz Republic was into corporate bonds of a local bank.

1 Information provided by the EBRD Warsaw Resident Office.

A separate category of LCM-supportive projects were the Bank's investments into **LCM infrastructure** which, during the evaluation period, comprised equity investments into four stock exchanges and participation in a bond issued by one of the stock exchanges (see Table 5).

The investments into stock exchanges were highly relevant as such exchanges are at the heart of each country's LCM. Their operations can encourage or deter listings, issue of securities and investments, which are key to LCM development. By acquiring shareholdings in four stock exchanges, the Bank was able to nominate candidates for election to the boards of directors and influence improvements in the corporate governance of the exchanges, as well as setting standards for the companies listed on them, effectively doubling the impact of each investment. The investments in Bucharest and Moscow stock exchanges were sample projects for this evaluation; their results are described in Annex 5 and summarised below.

At the **Moscow Stock Exchange,** the Bank's board nominee played a leading role in setting up the strategy, planning and audit committees and then guiding their work over subsequent years. Corporate governance was raised to international standards (some interviewees were of the opinion that the Moscow Stock Exchange was the best-governed company in Russia). The Bank's Director championed the introduction of a new corporate governance code for listing companies and to simplify the listing segments. These improvements introduced higher standards for companies listing on the main market, while making it easier for small- and medium-sized enterprises to list on the lower-segment market.

The director nominated by the Bank at the **Bucharest Stock Exchange** introduced similar improvements, including a new code of compliance for Bucharest Stock Exchange, a more rigorous disclosure process, and more stringent rules for listed companies. The Bucharest Stock Exchange's Chief Executive Officer stressed that the EBRD's involvement provided the exchange's management with a "moral mandate" to push for higher corporate governance standards and, without the EBRD's insistence, these standards may not have been introduced. The success of both projects was largely due to the support, commitment and genuine interest of the governments, the stock exchange shareholders and management, as well as the expertise of the Bank's nominated directors, who were highly praised by both clients.

Investments in Borsa Istanbul and Zagrebacka Bursa were too recent to fully assess their impact, but there are high expectations and the EvD reviewed their status. In the case of **Borsa Istanbul**, the EBRD was the sole major investor. The director nominated by the Bank (the same person who performed well at the Moscow Stock Exchange) has started working with Borsa Istanbul's management on the adoption of higher listing standards. At the same time, the Bank-hired central counterparty clearing houses expert entered into discussions with Borsa Istanbul's subsidiary, Takasbank, on bringing its central counterparty clearing houses into compliance with the European Markets Infrastructure Regulation standards. The initial public offering has not happened yet, Borsa Istanbul experienced management changes, and the overall investment climate in Turkey has deteriorated since July 2016, putting the project's future impact at risk.

The investment in **Zagrabecka Bursa** (Zagreb Stock Exchange) was very small (€0.8 million), although it gave the Bank the right to nominate one of its board directors. Following this investment, the Zagreb Stock Exchange acquired Ljubljana Stock Exchange and it has been at the forefront of the SEE Link project to better integrate the fragmented Balkan capital

**TABLE 5: BANK INVESTMENTS INTO STOCK EXCHANGES**

| **Stock exchange** | **Country** | **Year invested** | **Invested** (million €) | **EBRD's stake exchange** (%) | **Co-investors/ co-owners** |
|---|---|---|---|---|---|
| Moscow Stock Exchange | Russia | 2012 | 200.00 | 6.0 | Local banks and brokers |
| Bucharest Stock Exchange | Romania | 2014 | 2.75 | 6.0 | Local (70%) and foreign institutional investors |
| Borsa Istanbul | Turkey | 2015 | 112.00 | 10.0 | Nasdaq, brokers, government |
| Zagrebacka Burza | Croatia | 2015 | 0.80 | 5.2 | Local brokers |
| Warsaw Stock Exchange | Poland | 2015 | 4.70 | 0.0 (bond) | Banks, institutional investors |

markets (see the next section for more information). Therefore, Zagreb Stock Exchange is becoming a regional leader in the Western Balkans and the project impact is expected to be strong, especially as it has recently been 'clustered' with other Bank interventions, such as the issue of the city of Zagreb municipal bond and a TC on derivatives law (see Box 6). The Bank's consultant has been working on lower-tier regulations for small- and medium-sized enterprises to attract more listings, and strengthening its Supervisory Board by delegating tasks from the Shareholders Assembly. It is too early to assess impacts but the increased clustering of projects, combined with Croatia's accession to the EU and adoption of EU capital market regulations, allows some confidence in positive outcomes.

The Bank has not invested into other types of LCM infrastructure apart from stock exchanges, although the LC2 team has worked on several TC projects supporting central counterparty clearing houses and central security depositories in various countries, with a view to generating investment opportunities. The LC2 team has also played an instrumental role in the creation of the SEE Link and cooperated with the Warsaw Stock Exchange on its benchmarking (see next section).

## 6.2. Technical assistance and policy dialogue in support of LCMs

### Main findings

- In all, 40 TCs amounting to €14.8 million were approved under LC2, covering diagnostic studies, regulatory capacity-building and legal reforms; about half have been completed. The bulk went to ETCs and the southern and eastern Mediterranean.
- Evaluated samples show many achieved specific outputs but with little evidence of broader outcomes or impacts.
- The Bank's interventions have been generally fragmented, resulting in weak coherence across different segments of the capital markets. In most cases, while isolated TCs were appreciated by direct beneficiaries, other market participants saw them as of limited benefit for their own businesses.
- Fragmentation also partly reflected the Bank's reliance on external financial sources for TCs; donor preferences and ad hoc opportunities (rapid-response interventions) appear to be primary drivers of TC choices.
- TCs usually targeted very specific issues, while policy dialogue generally focused on a specific product or transaction. It was often undertaken as a rapid response to newly emerged needs, rather than to the larger strategic priorities identified in the Bank's own prior needs assessments. This reflected insufficient Bank capacity as well as lack of priority/political ownership by countries of operations. The LCM is often not a priority in the midst of larger reforms and often lacks effective ownership within the government.
- Policy-dialogue effectiveness appears limited to very specific issues in selected countries; there is no evidence of a causal role in larger systemic policy or institutional reforms. Lack of a more strategic approach to policy dialogue was hindered by a lack of agreed LCM objectives and action plans.
- Memoranda of understanding (MoUs) containing such action plans were signed with all ETCs, but with only two non-ETCs (Tunisia and Ukraine). Review of the Ukraine MoU and Action Plan confirms that it is too general to serve as a basis for strategically focused policy dialogue and TC.

- Relative success of TC and policy dialogue is greater in certain areas – infrastructure, legal and regulatory reform – than others (pension reform). Political sensitivity on pension reform was the main reason for slow progress. However, given the importance of pension reform for LCMs, there is a need to reconfigure the Bank's approach for greater engagement and effectiveness.

  - Development of two standard products for legal and regulatory policy dialogue (derivatives and covered bonds laws) improved efficiency and widened application; but their range in terms of banking transactions was limited and they were often not strategic priorities. However, their availability promoted hedging and LCY products.

  - There is some evidence that clustering interventions at different levels in small markets can yield better effects; these cases also featured close involvement of LC2 liaison officers at the resident office level.

Under the original LC2 initiative, LCM-focused TCs supported diagnostic work in the form of country-level needs and legal assessments, done mainly through the internal working group. Needs assessments were prepared for 16 countries and legal assessments for 14. These built on earlier assessments prepared by the Legal Transition team and generally involved joint missions with the IMF and the World Bank Group. They usually set four to six short-term and several long-term priorities for each country's LCM development (Annex 1). Evaluation of four country samples found a relatively weak link between the priorities set out in the needs assessments and actual Bank interventions; links between the legal assessments and Bank interventions tended to be stronger (Annex 6). Many priorities identified by needs assessments were large policy issues, beyond the capacity of LC2 team resources, and in addition politically very challenging (for example, currency liberalisation in Ukraine and pension reform in Poland). The Bank instead focused on smaller measures (often identified by legal assessments) seen as more within reach, such as amendment of a derivatives law or development of covered bond laws. The Bank also frequently intervened in response to ad hoc country of operations requests (rapid-response interventions) although not identified as priorities by needs or legal assessments. Many TCs commenced well after completion of assessments and in the context of changed circumstances on the ground, which confirms the evolving nature of country capital market needs and therefore a requirement to align the assessment process with them (that is, ensuring regular updates).

During the pre-evaluation period (to 2012), the Treasury worked mainly in Romania and Russia, and then in Kazakhstan and Ukraine, on the establishment of indices such as MosPrime. The EBRD Legal Transition team worked on model laws for investor protection in the Commonwealth of Independent States and securities markets (such model laws were adopted in Armenia and Ukraine), helped improve the legal and regulatory framework for bonds in Russia and helped draft a corporate and municipal bond law in Albania. Execution of these disparate activities across multiple departments, with minimal coordination, was a basic feature of early work under the Initiative.

Establishment of a dedicated LC2 team under the LC2 strategy at the end of 2012 was specifically intended to accomplish better coordination of technical assistance and policy dialogue in support of LCMs. Specifically, this was to be shaped by the strategy while particular interventions for each country were to be guided by diagnostic assessments.

Between 2012 and 2015, 40 TCs amounting to €14.8 million were approved; by the end of 2016, 18 of these TC projects were completed. A further 22 TC projects for about €8.7 million were in the works (Annex 3). Some 13 TCs were either diagnostic studies (usually for specific market products) or had a strong diagnostic component, often regional. These studies focused on ETCs and the southern and eastern Mediterranean, largely reflecting donor preferences. There is evidence that some studies helped subsequent development of several TCs (although not investments), such as the Central Securities Deposit development at the Central Bank of Egypt, Derivatives Law Improvement in Morocco, Private Equity TC in Egypt, or Real Estate Investment Trust regulations in Egypt and Morocco.

The scope and diversity of **policy dialogue** increased after the LC2 team took leadership of the Initiative. Technical advice was provided through frequent contact (ad hoc or as part of a dedicated TC) between staff and country-of-operations policy-makers. Nearly all TCs had an element of policy dialogue; 12 are identified by the EvD as having a strong and focused policy dialogue component, including: Jordan Capital Market Action Plan, which assisted implementation of the LCM development plan; the Benchmarking of Warsaw Stock Exchange; and the Review of Trading Rules of the Moldovan Stock Exchange. In most cases these linked diagnostic and policy dialogue elements, as the conclusions of a diagnostic component paved the way for the dialogue on policy changes. Most of these TCs are ongoing and results cannot be assessed.

The Bank developed two products for legal and regulatory reform policy dialogue – the derivatives law and the covered bond law – which were implemented under several TCs in multiple countries. While the Bank was able to deliver these products efficiently, it is not clear whether they reflected country-of-operations priorities or that sequencing within a larger LCM reform process was considered. For example, fine-tuning a derivatives law for a relatively underdeveloped and fragmented Ukrainian market with a weak money market might be questioned as a top priority for LCM development in the context of more basic needs, which were also identified by the needs and legal assessments. So far, a Bank-supported derivatives law has been adopted in Armenia and a covered bond law in Poland and Romania. Covered bonds have already been issued under this law in Poland, adding to market depth and diversity. Availability of derivatives instruments is important for hedging and creates a platform for financial market intermediaries, including the EBRD, to offer an expanded range of LCY products.

The Bank also supported policy dialogue around the LC2 theme of building a **stable and sustainable macroeconomic policy framework**. One TC, for example, supported forecasting models for four ETCs; another provided support for a yield-curve pricing model. However, this work was agreed to be beyond the scope of this evaluation and is not assessed here.

Policy dialogue and TCs also focused on LCM **infrastructure**, particularly stock exchanges and trading platforms. One of the largest TCs was the SEE Link, which created a cross-border trading platform managed by Zagreb Stock Exchange linking smaller exchanges in the Balkan States. The EvD's case study under this review (see Annex 4) confirmed its potential to play a key role in the integration of the fragmented Balkan capital markets. The LC2 team began to address other LCM infrastructure needs (for example, related to the payments and securities settlement systems) relatively recently. An important TC (and the LC2 initiative's largest to date, of €6.7 million) was launched in 2015 to establish the Central Securities Deposit at the Central Bank of Egypt. This project is ongoing and reportedly on track. A recent (2016) project with Borsa Istanbul aims at creating a new corporate bond index, which has potential to make a strong contribution to bond market development in Turkey.

TCs specifically targeting **capacity-building** were also approved during the evaluation period (amounting to €460,000) for training, conferences and seminars, on laws and regulations at the London Stock Exchange, judicial training in financial instruments, an infrastructure finance conference in Turkey, and a workshop for high-level decision-makers on gap analysis and optimal infrastructure in Ukraine. These efforts are generally favourably regarded by participants and constitute a notable part of the Bank's offer. However, as with most other such capacity-building efforts, they tend to be constructed exclusively in terms of delivery of inputs (training, events); there is typically very little capacity to develop an evidence-based view of effectiveness in terms of skills actually developed and applied. There is substantial scope for improved design and monitoring with respect to the intended outcomes from this work.

## 6.3. LCM-supportive Treasury operations

### Main findings

- Treasury and OGC Finance made innovative and pioneering issues and supported legislative changes important for developing small markets such as Armenia and Georgia. They have been working for several years to prepare domestic Serbian and Ukrainian bond issues, contributing in the process to the improved regulatory and legal environments.
- Treasury also promoted LCMs through pioneering derivative transactions and capacity-building.
- New domestic LCY bond issues were rare (only in three countries in four years), and long time frames can be required (over 10 years) for issuing bonds in Serbia and prospectively in Ukraine. During 2012-15 Treasury issued six domestic LCY bonds in two countries (four in Armenia and two in Georgia). They joined the domestic bonds issued earlier in Romania and Russia and helped diversify and deepen these markets. These issues were accompanied by legal and policy changes.
- Bank domestic LCY bond issues have had positive impact on LCMs: they offered rare triple-A investment alternatives to government bonds and contributed to development of interest benchmarks in the four countries where they were issued.
- There is evidence that LCY Eurobonds and synthetic bonds (LCY-linked) attracted international investors. However, beyond that there is little evidence of impact on LCMs (for example, the subsequent engagement of such investors in the local markets).

The Bank's triple-A rating has less value in domestic markets where the government is also triple-A rated. Higher cost and the limited demand for LCY from the Bank's clients constrain the Treasury's ability to issue domestic bonds.

By borrowing in LCY the Bank's Treasury can play an important role in stimulating LCM development; as a financial obligation of the highest (triple-A) credit rating, Bank bonds define an interest rate benchmark that may serve as an alternative to an often illiquid government bond market. Such benchmarks are needed to define the pricing of all other obligations in the financial market (such as corporate bonds). In addition, the EBRD floating-rate bonds can introduce innovative and highly standardised procedures to LCMs, which may help to foster their broader development. Finally Bank bonds allow a more efficient allocation of risk on LCMs as local investors, such as pension funds, may diversify their credit risk beyond what is likely to be a narrowly defined set of local assets.

During the evaluation period (2012-15), the Treasury Department and OGC Finance worked to prepare the issue of the Bank's own domestic bonds in Armenia, Azerbaijan, Georgia, Kazakhstan, Kyrgyz Republic, Russia, Serbia, Tajikistan, Tunisia, Turkmenistan and Ukraine. Bonds were issued in Armenia in 2014 (AMD2 billion [€3 million], repeated in 2015). They were also issued in Georgia in 2013 (GEL50 million [€21 million], 2015 (GEL25 million [€10 million]) and 2016 (GEL100 million [€27 million]). The EBRD's two Consumer Price Index-linked eurobonds (each for KZT34 billion [€95 million]) were issued in Kazakhstan in November and December 2016 (after the evaluation period), as a result of protracted discussions with the domestic authorities including during the evaluation period. Similarly, the bond in Serbia (RSD2.5 billion [€20 million]) issued in December 2016 was the result of over 10 years of work with the regulators to make requisite amendments. The Bank has also worked for over 10 years on a domestic bond in Ukraine (see Box 5); however, the bond has not yet been issued.

The issue of the Armenian bond was combined with other LCM-supportive interventions (see Box 6), which amplified its market impact and probably contributed to Armenia's LCM development transition impact upgrade. The issue of three Georgian bonds was also accompanied by work on inflation targeting. The first bond was the first IFI bond issue and inaugurated the domestic floating-rate note market (with variable coupon). The

## Box 5. Policy dialogue in Ukraine to support domestic bond issue

- In 2013 the Securities Market Law was amended to permit IFI bond issuance.
- From 2014 to 2015 the EBRD worked with the Securities Commission on amendments to issuance procedures and information disclosure rules.
- The Bank obtained a confirmation from the National Bank of Ukraine that IFI bonds can be used as collateral for loan and direct repo transactions by local market players.
- The EBRD obtained market and currency consent from the Ministry of Finance.
- The Securities Commission agreed issuance procedures and disclosure rules for IFI bonds, and approved the list of stock exchanges for public placement of IFI bonds.
- The agreement is with the national depository of Ukraine.
- The Bank is still working on the amendments to the Securities Market Law (in respect of the bondholder meeting rules).

Bank obtained repo eligibility for this bond from the Georgian regulator. The bond was a private placement (offered to qualified institutional investors); however, the Bank issued another domestic bond in Georgia in 2016, a public offering listed on the Georgian Stock Exchange which is expected to have a more substantial impact, adding to the capitalisation and diversity of this market.

The domestic bond issues required legal and regulatory changes in the domestic markets to enable the issues. Therefore, Treasury and OGC Finance were involved in intensive policy dialogue in all five countries. Box 5 presents the Bank's accomplishments in this process in Ukraine.

Domestic bond issues require substantial resources and time. The Treasury has been issuing large numbers of LCY Eurobonds (or 'synthetic bonds'). These are Eurobonds with the coupons payable in euros, Japanese yen or US$ foreign exchange rate to an LCY as specified. They are issued in the international markets under the Bank's Medium Term Note Programme and settled through the international central securities depositories (such as Clearstream and Euroclear) and documented under English law (that is, they do not require lengthy policy dialogue to change domestic legislation). The investors take the LCY foreign exchange risk. LCY Eurobonds do not add to the capitalisation or liquidity of the LCMs and their role in promoting LCMs has been limited to helping develop yield curves for pricing domestic bonds and the introduction of new investors, who might follow their investment in euro or synthetic bonds with an investment in an LCM. They have also enabled local currency loans that are important in developing the LCM. The Treasury confirmed that there is evidence that LCY Eurobonds have attracted international investors as central banks in Armenia and Georgia sought to establish a bridge between their central security depositories and international central security depositories.

The Treasury department also prepared a framework for developing money markets in frontier and emerging market economies. This was directed to the policy-makers working on the development of the LCMs and contained a step-by-step guide to the development of money markets. Its central message was that the development of resilient and well-functioning money markets is deeply intertwined with the development of a monetary policy framework based on a flexible exchange rate and the pursuit of low and stable inflation (for example, through inflation targeting). It emphasises that reforms focused solely on the money market mechanics will have only limited chances of success if not accompanied by sustained efforts to achieve low and stable inflation using a predictable interest rate policy and a flexible exchange rate. But it also warned that the implementation of such policy frameworks will struggle to succeed without efforts to build well-functioning money markets. This guide has been distributed to financial policy-makers in countries of operations and, according to the LC2 team, one can observe decisions and actions being taken based on its principles in some countries of operations (such as Armenia, Georgia and Kyrgyz Republic).

The Treasury also executed a number of derivative transactions, such as cross-currency swaps, which led to the establishment of pools of liquidity in Hungarian forint, Kazakhstan tenge, Polish zloty, Romanian lei, Russian rouble and Turkish lira. These transactions promoted the use of International Swaps and Derivatives Association master agreements, which embedded such concepts as netting and close-out netting. Swap agreements were established with central banks in the southern and eastern Mediterranean countries of operations.


Annexes may be viewed at www.ebrd.com/evaluation

## 6.4. Cooperation with other organisations

### Main findings

- The Bank played an active role in setting up a coordinating structure for IFI efforts in LCM development; namely co-creating with the International Finance Corporation (IFC) the Senior Forum for Local Capital and Markets Development, which has been the main forum for information exchange and coordination.
- At an early stage of the Initiative the Bank successfully cooperated with the IMF and the World Bank Group to produce country needs and legal assessments.
- Although there are some cases of co-funding of TCs, the Bank has been unable to share its LCM development projects with those of other IFIs. Other IFIs often have different priorities and lack dedicated LCM development strategies. There has been an absence of joint projects or common policy statements.
- There are some synergies between the Bank's and the IFC's work towards LCM development which could be better explored to undertake joint pilot actions.

The Bank coordinated and cooperated with other IFIs and international organisations on LCM development, mainly through the LC2 team, although Banking and Treasury departments were also often involved.

- **Collaboration on diagnostic studies:** The Bank cooperated with the IMF, the World Bank Group and, in some cases, the EU on country diagnostics, undertaking joint missions and meetings as well as coordinating messages contained in the reports.
- **Coordination of LCM development activities:** In 2013 the Bank and the IFC co-created the Senior Forum for Local Capital and Markets Development – a platform for the exchange of information and coordination of policy actions among IFIs involved in LCM development. It meets biannually and the LC2 team participates in several of the Forum's working groups, such as a Bond Market Development Group. The Bank's main achievement in the Forum has been that it elevated the policy dialogue to the top of the agenda (the earlier focus was on investments) and effectively coordinated policy dialogue actions among different IFIs. For instance, the Bank led the policy dialogue in Armenia, while the World Bank Group took the lead in Georgia. The Forum also helps IFIs to agree on who undertakes specific TCs in which country, which helps avoid overlaps.
- **Co-funding of TC** has been rare but has occurred in some cases, for example for the Central Securities Depository TC for government securities at the Central Bank of Egypt (co-financed with the African Development Bank) and the preparation of a Kyrgyz corporate bond issue (co-financed by KfW).
- **Coordination of policy actions:** As the EBRD primarily finances the private sector, it does not normally enter into legal agreements with governments (beyond MoUs). Therefore, it sometimes undertakes policy dialogue together with (or on the back of) other IFIs' agreements, which have conditionality attached to their sovereign loans. For example, conditions related to LCM development projects (including those implemented by the EBRD) were included in the IMF financial packages for several countries. However, there have been no joint policy statements.
- **Participation in international initiatives:** The Bank takes part in the Deauville Partnership, launched by the G8 to support reform across the Arab world, together with the Arab Monetary Fund, European Investment Bank, IMF, Islamic Development Bank and the World Bank Group, among others. For instance, the Bank cooperated closely with the Arab Monetary Fund on guidance for its policy dialogue, and recently launched TCs in Egypt, Jordan and Morocco.
- **Cooperation with the EU:** The Bank has been in dialogue with the European Commission on the EU Capital Markets Union, which works towards removing barriers and harmonisation of capital

market regulations to promote cross-border capital flows in the member countries. Its focus has been on bigger countries (France, Germany, UK) and the Bank's main achievement has been bringing regulatory deficiencies in the Bank's countries of operations to the EU's attention, resulting in the Union's more extensive involvement in Poland, Romania and Slovak Republic, which led to addressing many of the deficiencies (offsetting lack of TC funding for policy dialogue in more advanced countries).

- **Cooperation with industry associations:** The Bank has cooperated with the International Swaps and Derivatives Association on regulatory projects (mainly derivative trading regulations), using the association's model agreements and the know-how of Bank experts, for example in Armenia, Morocco, Russia and Ukraine. The International Swaps and Derivatives Association also issued support letters recommending follow-up on the Bank's recommendations. The LC2 team director has been elected to the Board of the Federation of Euro-Asian Stock Exchanges, which links 34 stock exchanges including 28 in countries of operations. The Bank's main achievement has been the promotion of integration of stock exchanges (based on the SEE Link model) for smaller countries. It has been well received and is being examined by stock exchanges in the Caucasus and Central Asia, which might follow suit. The Bank was also closely involved in the work of the International Organisation of Security Commissions, which served as a forum for promoting regulatory reforms (for example, in Ukraine) as well as exchanging experiences from regulatory projects among IFIs.

The LC2 team believes that while cooperation with IFIs and international organisations could be more extensive it would have to come at the expense of other activities given existing very limited resources. The Bank's experience so far has been that, despite declarations and an earlier agreement to cooperate on the development of LCMs, the IFIs have different priorities and approaches. Close cooperation resulting in, for example, joint policy statements or joint TCs has not been accomplished. For instance, the IMF and the EBRD are both interested in promoting macroeconomic stability through inflation targeting and the development of a reference yield curve. There has been regular coordination and exchange of information in this field through the Senior Forum and meetings with the IMF's Mission Heads. However, the IMF does not have a comprehensive LCM development programme, as its activities are geared towards promoting financial stability and crisis response. The World Bank's priority in LCM development has been supporting government bond markets to create more liquid yield curves as benchmarks for corporate bonds, rather than promoting corporate issues directly; this would seem to offer good prospects for mutually beneficial cooperation. The EBRD believes that it is perceived as the leader among IFIs in champioining LCM development and until recently was the only IFI with a team dedicated to LC2.

The IFC is the Bank's most likely collaborator and both institutions have been in close contact, co-funding and leading the Senior Forum. Common areas of interest include the promotion of corporate bonds, legal and regulatory reform, and corporate governance improvements. However, the IFC's advice has been, in principle, fee-based (rather than grant-funded) and therefore not always acceptable to beneficiaries, making it difficult to structure joint TCs. Moreover, the IFC's work in LCM development has concentrated on Brazil, India, Indonesia and Pakistan. It also works in smaller countries and the LC2 team coordinated with the IFC on its assistance for regulators and legal reforms in countries such as Armenia, Georgia, Kyrgyz Republic and Tajikistan. Opportunity could emerge to cooperate with the IFC's recent creation of a dedicated LC2 unit.

Other IFIs have also been active in LCM development in Egypt, Morocco and Turkey, creating opportunities for cooperation and/or joint investments with the Bank, which should be better explored. One attempt at a joint investment with the IFC failed in the end when the IFC decided not to invest for commercial reasons. The Bank also collaborated with the World Bank Group when providing assistance for the Moroccan government's market reforms. Both institutions held joint meetings and supported each other's solutions; however, there has been a clear division of work, with the World Bank leading securities-lending-law development and the EBRD working on a derivatives law.

In December 2016 the World Bank Group's Independent Evaluation Group published a report, *The World Bank Group's Support to Capital Market Development* (Independent Evaluation Group, World Bank Group, 2016), which evaluates the Group's LCM-supportive operations during 2004-14, but it also makes plain some key differences in the World Bank Group's and the EBRD's approaches to LCM development, as well as selected common areas of potential cooperation.

The Bank has been actively liaising with the Asian Development Bank (ADB) on its Credit Guarantee Lending Facility (co-financed by Republic of Korea, Japan and Taiwan), as ADB has prioritised the establishment of credit guarantee and investment facilities to support the issue of LCY bonds, improving regulatory framework and supporting market infrastructure development. Due to this coordination, ADB's focus has been on countries other than the EBRD's countries of operations, although the LC2 team believes that there might be some potential for future cooperation with ADB in the Caucasus and Central Asia, particularly on policy dialogue (ADB works primarily with governments).

# 7

# Evaluation results

The evaluation assessed LCM-supportive interventions at both project and macro levels to determine the extent to which they achieved their desired outputs and outcomes, and to identify evidence of any early impacts. This section summarises the main findings.

## Main findings – project level

- Most projects reviewed achieved intended outputs as specified. However, so far there has been limited evidence (with some exceptions) that they have generated broader outcomes or significantly impacted LCMs.

- Where such evidence exists, it is related mainly to direct investments into stock exchanges, which improved corporate governance and the standards of listed companies. There was also evidence of a positive, broader impact on the Greek LCMs where the Bank was an anchor investor in a corporate bond issue.

## Main findings – macro level

- During the evaluation period more countries had their LCM development transition indicators and gaps downgraded than upgraded.
- Downgraded countries included Poland and Romania where the Bank made the bulk of its investments. This result points to the overall limited impact of the Bank's usually narrowly focused interventions in the context of negative macro-policy changes.

- There is some evidence of causal links between the upgraded LCM development indicators in Armenia and Croatia and the Bank's interventions, which were clustered at different levels of the same market.
- Overall the stock markets in the Bank's LC2 main target countries were mostly stagnant during the review period. Their capitalisation and share in GDPs decreased or grew very modestly (the EU and Turkey), contracting sharply in Russia and Ukraine.

## 7.1. Evaluation results – project level

Performance at the project level was assessed on the basis of a sample of nine LCM development projects (four investments, four TCs and one project combining an investment and a TC) and evaluated for relevance, effectiveness and efficiency. Results are summarised below with details presented in Annexes 4 and 5.

The **relevance** of LCM projects was generally excellent as almost all of them responded well to priorities identified in the LCM legal assessments (although rarely to those identified in the needs assessments). Most fit with one or more LC2 focus themes defined in the strategy. Anecdotal evidence from interviews in EBRD countries of operations tended to confirm a perception of relevance and fit with national LCM development issues.

In terms of **effectiveness**, case studies and sample projects showed that most achieved their outputs (such as introduced new products, created new trading platform, produced new laws). However, there is limited evidence that projects can be credited with generating broader outcomes or higher-level impacts on LCMs, such as laws being approved or substantial follow-up on pilot bond issues. A factor here may be the relatively recent vintage of some projects; several were rated only for potential rather than actual results.

There were some cases where older LCM projects achieved desired outcomes and impacts, such as investments in the Moscow Stock Exchange and the OTE Greek corporate bond. Both had positive impact on LCMs: the former had far-reaching corporate governance improvements (not only to the stock exchange itself but also to the standards of listed companies), while the latter was associated with a revival of issues on the Greek corporate bond market.

**TABLE 6: RESULTS OF EVALUATION OF THREE CASE STUDY AND SIX SAMPLE LCM SUPPORTIVE PROJECTS**

| Project | Relevance | Effectiveness (results) | Efficiency | Overall impact on LCMs |
|---|---|---|---|---|
| Ukrainian derivatives law TC | Fully satisfactory | Partly unsatisfactory | Fully satisfactory | Acceptable |
| South-Eastern Europe Trading Platform (SEE Link) trading platform TC | Fully satisfactory | Fully satisfactory (potential) | Fully satisfactory | Good (potential) |
| Bucharest Muni Bond (investment) | Excellent | Fully satisfactory (potential) | Fully satisfactory | Good (potential) |
| Covered bonds law in Poland TC | Excellent | Fully satisfactory | Fully satisfactory | Good |
| Bucharest Stock Exchange (investment) | Excellent | Fully satisfactory | Fully satisfactory | Good |
| Derivative law development in Morocco TC | Excellent | Fully satisfactory (potential) | Fully satisfactory | Good (potential) |
| Moscow Stock Exchange (investment) | Excellent | Excellent | Partly unsatisfactory | Outstanding |
| Kyrgyz Bond TC and investment | Excellent | Fully satisfactory | Fully satisfactory | Good |
| OTE corporate bond (investment) | Excellent | Excellent | Excellent | Outstanding |

Notes:
The following rating scales apply:
Criteria: Excellent – Fully satisfactory – Partly unsatisfactory – Unsatisfactory.
Overall performance: Outstanding – Good – Acceptable – Below standard – Poor – Very poor.
OTE = Hellenic Telecommunications Organisation S.A.; TC = technical cooperation project.

Many other projects (recently completed or still ongoing) have the potential for impact in the future. Only one project – derivatives law development in Ukraine – received a relatively low rating because it has been ongoing since 2012 and, despite many promises, the law has not yet been approved.

Project **efficiency** was generally good, except for investment in the Moscow Stock Exchange where rouble depreciation contributed to a large loss as of mid-2016. Even so, rated transition impact for this project was excellent.

## 7.2. Evaluation results – macro level

The LC2 strategy proposed monitoring based on tracking changes in country-of-operations transition gaps (or indicators), reported through the Bank's routine assessment of transition challenges (unpublished). Annex 9 presents LCM development transition indicators for all EBRD countries of operations between 2011 and 2016 and transition gaps between 2012 and 2014 (the latest gap assessment). This section presents analysis of the indicators and gap movements during these periods, as well as the evolution of basic stock market indicators for key countries where the Bank operated.

From 2011 to 2016 LCM **Transition Indicators** were upgraded for **five** countries and downgraded for **seven**. The EvD sees no causal links between four of the upgrades (Bosnia and Herzegovina, Latvia, Slovenia and Turkey) and the Bank's activities. The upgrade in **Croatia** (3 to 3+), where the Bank has been clustering several LCM projects since 2015, could partially reflect Bank interventions; however, caution is needed with attribution in this case given Croatia's accession to the EU and adoption of the EU's capital markets legislation.

Turkey's LCM transition indicator was upgraded and the Bank made a substantial investment into Borsa Istanbul in 2015. However, causal attribution would not be appropriate as an envisaged initial public offering has not happened and the Bank's Board nominee has only recently been appointed.

The seven cases where LCM ratings were reduced include Romania, Serbia and Ukraine – where the Bank provided some support for LCM development during the evaluation period. The downgrade in Ukraine primarily reflects the deterioration of its

## Box 6. Clustered projects approach to LCM development in Armenia and Croatia

**Armenia:** In 2014 there were several Bank interventions in Armenia, including TC on a derivatives law, which was subsequently adopted, and a TC on inflation targeting and forecasting and policy analysis system model development. These TCs were combined with Bank investments into two Armenian companies (a local bank and a mining company) listed on the Armenian Stock Exchange which, due to its small size, gave the EBRD's investments high visibility, reflecting the Bank's seal of approval for this LCM. Subsequently, the same year, the Bank's Treasury issued an AMD2 billion floating rate bond on the Armenian domestic market, using an auction mechanism for price setting. The bond was listed on the Armenian capital market (NASDAQ OMX-Armenia). The EBRD obtained repo-eligibility for these bonds and further contributed by introducing regulatory amendments and technical modifications to NASDAQ OMX-Armenia.

**Croatia:** In 2015 the Bank acquired a 5.25 per cent stake in the Zagreb Stock Exchange, nominating one of its board directors. That director has been working on improving its corporate governance (strengthening the Supervisory Board by delegating down from the Shareholders Assembly to the Supervisory Board) and introducing lower-tier regulations for small and medium-sized enterprises to attract more listings (an action connected to the Small and Medium Enterprise Growth Market project). Following this investment Zagreb Stock Exchange acquired Ljubljana Stock Exchange and it has been at the forefront of the Bank-financed SEE Link project to better integrate fragmented Balkan capital markets, becoming a regional leader in the Western Balkans. The same year the Bank launched a €100,000 TC project to implement a legal and regulatory framework for covered bonds in Croatia, introducing a new product and stimulating more issues and market liquidity. Subsequently, the LC2 and municipal and environmental infrastructure teams worked together on the issue of the Zagreb city municipal bond, in which the Bank invested, and the EBRD organised a partial exit from one of its Croatian investments through an offer on the country's over the counter private company market. Recently, the LC2 team also worked with the Croatian cloud funding platform, introducing innovative market solutions.

political and economic situation. Downgrades for Serbia (EU candidate country) and especially Romania are particularly telling as the latter received relatively substantial investments and several TCs from the Bank.

Comparing the latest assessment of transition challenges for 2014 with 2012 shows that LCM structure improved only in Turkey (and deteriorated in Hungary, Jordan and Kazakhstan), while market institutions improved in Armenia and Tunisia but deteriorated in Jordan, Moldova and Poland.

The upgrade of Armenia could be partially attributed to multiple Bank interventions there, but a greater part of the credit should probably go to the NASDAQ subsidiary for its efficient operation of the Armenian Stock Exchange.[2]

Such clustering of the Bank's interventions on several market levels increased their chances of positive effects on broader LCM development. It also gave the Bank better visibility and raised its profile, which in turn helped it deliver its policy messages, promoting wider reforms.

At the other end of the spectrum, one of the downgraded countries was Poland, where the Bank made by far the majority of its LCM-supportive investments. However, the downgrade was mainly due to the government's decision in 2013 to transfer pillar 2 pension funds (under private management) into a government-managed scheme, effectively eliminating local pension funds from the Polish LCMs. This type of policy reversal (which also affected LCM development in Hungary and Kazakhstan) is very difficult to foresee and mitigate.

**Stock markets** in the main LC2 target countries during 2011-15 were largely stagnant. Although the number of listings increased in most (except Ukraine), turnover was lower in all of them. Other important LCM development indicators (market capitalisation and its

2 The Armenian Stock Exchange and Central Depository have been operated by OMX Group since 2007. In 2008 US NASDAQ and OMX Group merged, creating NASDAQ OMX – the world's largest operator of stock exchanges.

share in GDP) decreased slightly or grew very modestly in EU countries and Turkey, but contracted sharply in Russia and Ukraine. This was partly due to currency movements and illustrates the difficulty of progressing LCM development in unstable political and economic environments.

The trends observed in the Bank's countries of operations were in contrast to those in mature markets, such as Germany and the UK, where listings and turnovers decreased, while market capitalisations and their share in GDP increased. Some other emerging markets (such as Vietnam) recorded increases across all of their LCM development indicators (see Table 7). However, the Bank played only a relatively small role in the country-of-operations stock markets and a slightly more substantial one in selected corporate bond markets.

**TABLE 7: BASIC STOCK MARKET DEVELOPMENT INDICATORS FOR SELECTED COUNTRIES OF OPERATIONS AND INTERNATIONAL PEERS**

| Stock market | 2011 | | | | | 2015 | | | | |
|---|---|---|---|---|---|---|---|---|---|---|
| | Stocks listed | Market value (MV) (US$ millions) | Turnover (US$ millions) | MV/GDP (%) | Turnover/MV (%) | Stocks listed | MV (US$ millions) | Turnover (US$ millions) | MV/GDP (%) | Turnover/MV (%) |
| Moscow | 304 | 783,554 | 554,231 | 38.6 | 70.7 | 316 | 393,238 | 117,317 | 29.7 | 29.8 |
| Warsaw | 757 | 138,244 | 73,064 | 26.1 | 52.9 | 872 | 137,770 | 52,628 | 29.0 | 38.2 |
| Bucharest | 79 | 14,023 | 2,930 | 7.6 | 20.9 | 82 | 18,539 | 1,618 | 10.4 | 8.7 |
| Istanbul | 263 | 197,074 | 361,076 | 25.4 | 183.2 | 392 | 188,861 | 349,685 | 26.3 | 185.2 |
| Kiev | 197 | 25,654 | 1,178 | 15.7 | 4.6 | 160 | 9,517 | 122 | 10.5 | 1.3 |
| London | 2,288 | 3,266,418 | 2,836,991 | 125.9 | 86.9 | 2,167 | 3,878,774 | 2,651,355 | 136.2 | 68.4 |
| Frankfurt | 670 | 1,184,500 | 1,758,185 | 31.5 | 148.4 | 555 | 1,715,800 | 1,555,549 | 51.1 | 90.7 |
| Vietnam | 306 | 21,574 | 7,492 | 15.9 | 34.7 | 307 | 51,877 | 18,898 | 26.8 | 36.4 |

Source: World Federation of Exchanges (unpublished).


# 8

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