PROGRAM INFORMATION DOCUMENT (PID)
APPRAISAL STAGE

November 1, 2016
Report No.: 109673

Operation Name	MA-Second Capital Market Development and SME Finance DPL
Region	MIDDLE EAST AND NORTH AFRICA
Country	Morocco
Sector	Capital markets (23%); Payments, settlements, and remittance systems (22%); General finance sector (22%); SME Finance (22%); Central government administration (11%)
Operation ID	P153603
Lending Instrument	Development Policy Lending
Borrower(s)	GOVERNMENT OF MOROCCO
Implementing Agency	
Date PID Prepared	September 20, 2016
Estimated Date of Appraisal	September 26, 2016
Estimated Date of Board Approval	January 31, 2017
Corporate Review Decision	Following the corporate review, the decision was taken to proceed with the appraisal and negotiation of the operation.
Other Decision	

I. Key development issues and rationale for Bank involvement

This project information document (PID) proposes the Second Capital Market Development and Small and Medium-Sized Enterprise (SME) Finance Development Policy Loan to the Kingdom of Morocco (DPL2) in the amount of US $450 million. The proposed operation is the second in a programmatic series of two. The first DPL was approved by the Board in April 2014 for US$300 million and closed in December 2014. The proposed operation supports the long-standing commitment of the Moroccan authorities to develop a more inclusive and diversified financial sector, and its steady implementation.

Morocco has pursued well sequenced, methodical, and increasingly complex reforms of its financial system for a decade and a half. A first wave of reforms phased government out of banking; a second wave focused on securing system stability; the current wave centers on liberalizing financial risk taking, enabling large borrowers to diversify financing beyond banks, reforming the pension system as the cornerstone of capital markets, and developing new financing solutions to meet the needs of MSMEs. Morocco is fast becoming the regional leader in financial inclusion and access, capitalizing on initiatives that started a decade ago.

The World Bank Group (WBG) has been privileged to support Morocco’s financial sector policies through several DPLs since 2005. All along, the WBG has maintained extensive technical engagements and contributed to deepening the policy dialogue. Implementation of reforms under the proposed operation will again be supported by comprehensive advisory and analytical work, designed to implement reforms, especially where complexity is a critical factor.

The proposed operation supports the WBG's Strategy for the Middle East and North Africa (MENA) region. The DPL promotes the renewal of a social contract in Morocco built on a diverse and resilient financial sector that responds to the needs of the Moroccan real economy. Financial institutions and markets underpin the buildup of essential infrastructure such as roads, power plants, schools, hospitals, and houses that boost growth, jobs, productivity, and welfare. Finance also generates growth and jobs by allocating scarce resources efficiently and allowing dynamic firms to start, grow, and innovate. Financial inclusion promotes economic well-being by assisting vulnerable households to build up productive assets, manage risks, and respond to financial shocks. This DPL supports reforms that put in place the requisite financial infrastructure and institutional environment to expand access to finance opportunities. In doing so, the operation supports a social contract in Morocco that includes a strong private sector that can create jobs and opportunities, particularly for Morocco's youth.

The operation also supports the strategy's pillar on regional cooperation, in this case assisting Morocco integrate toward Sub-Saharan Africa and beyond. Morocco is increasingly diversifying toward Sub-Saharan Africa to mitigate exposure to Europe in a low-growth context. The DPL also supports the Central Bank law that sets in place a crisis resolution framework for systemically important banks, many of which have complex holdings and operations across greater Africa.

The reforms are in line with the WBG's twin goals: they are expected to generate benefits for vulnerable public servants through the 50% increase in minimum pensions, as well as job opportunities by developing financing solutions for, and credit information on, MSMEs. The development of local capital markets will over time enable a more efficient allocation of capital, thus generating economic surplus through productivity gains, which will in turn finance policies targeting the most vulnerable. Safeguarding financial stability will ensure that Morocco's hard-won progress toward the twin goals is not reversed by a financial sector crisis.

II. Proposed Objective(s)

The proposed operation supports the core of the Government program to develop a more inclusive and diversified financial sector. The program development objectives of this DPL are to:

- Pillar A. Improve access to finance for small and young enterprises
- Pillar B. Strengthen capital markets by improving the institutional framework and broadening the range of instruments
- Pillar C. Improve the financial sustainability of the *Caisse Marocaine des Retraites*
- Pillar D. Strengthen oversight of the banking sector

III. Preliminary Description

The program is designed to support the Government of Morocco's (GoM) ambitious financial sector reform agenda to promote dynamism, expansion, and competitiveness of the private sector by modernizing the role of finance; introduce new solutions for the financing of MSMEs; and change the mix of bank and market financing, while safeguarding stability. Following fiscal consolidation, the GOM wants to stimulate private-sector-led infrastructure investment through capital market financing, public-private partnerships, and a more market-driven exchange rate. The GOM's financial sector policies are spelled out in policy documents, notably Budget Laws, presentations by the Minister of Finance, Governor of BAM, and heads of financial regulators.[1]

The prior actions of DPL2 continue to reflect extensive consultations between the authorities, stakeholders, and the World Bank Group (WBG). Each law or regulation goes through several rounds of consultations and vetting, several of which are formal. This translates into proposed changes in the wording of some prior actions for DPL2 compared to the triggers envisaged in 2014. The proposed operation comprise 10 prior actions, of which five are new compared to the triggers envisaged in DPL1: (i) two new mechanisms that provide financial support of qualifying MSMEs, (ii) one measure fostering transaction accounts and payments services, (iii) one measure introducing a new capital market instrument, and (iv) law on the central bank. The new prior actions reflect more ambitious reforms than envisaged in DPL1, reinforce the objectives of the DPL series regarding access to finance by MSMEs and financial stability, and add a dimension on financial inclusion in support of Morocco's policies toward universal access

Based on government consultations, the Bank and the Government have defined an extended menu of tentative prior actions for each development objective.

Pillar 1: Improve access to finance for small and young enterprises.

In the context of DPL1, this pillar focused on fostering the financing of small and young firms, which are difficult segments for banks to serve. The focus was justified by (a) the job intensity of MSMEs;[2] (b) encouraging unemployed young people to go into private-sector business; and (c) encouraging recent graduates to start companies of high growth potential in the digital economy. In DPL2, this pillar adds measures on Universal Financial Access (UFA) that enable access to a transaction account or electronic instrument to store money, send payments, and receive deposits. While the trigger on start-ups is dropped, the Bank is preparing an operation focused solely on providing equity financing to innovative start-ups through public-private fund partnerships and technical assistance to help entrepreneurs start and grow a viable business. The objective of this complementary operation is to encourage the private equity investment market to increase the supply of early stage investment finance for innovative SMEs.

Morocco leads the region in MSME access to finance, with 36 percent of bank loans to enterprises extended to MSMEs.[3] Such loans typically start at MAD 200,000, while microcredits are capped at MAD 50,000. The GOM incentivizes banks to lend to MSMEs and move down-market by means of guarantees and co-investments by the Credit Guarantee Fund (*Caisse Centrale de Garantie*—CCG), an agency receiving periodic allocations from the budget. A prior action for DPL1 was the CCG strategy for 2013–2016, in which the CCG diversified its offerings

[1] See special issue of MEF's quarterly review: https://www.finances.gov.ma/Docs/2016/DAAG/al%20maliya%20n60.pdf, 2016.
[2] An impact assessment of the EU SME guarantee facility in Central, Eastern, and South-Eastern Europe found the highest economic additionality for micro and young SMEs (European Investment Fund Discussion Paper 002, 2015).
[3] The Moroccan definition of MSMEs is companies with less than MAD 175 million turnover.

to better align with the diversity of MSME financing needs, eliminated eligibility criteria, and opened offices in the regions. By 2015, the CCG had exceeded its MSME lending target set in the 2013–2016 strategy by 60 percent. Specifically, the CCG boosted its guarantee portfolio from MAD 2 billion in 2011 to MAD 12 billion by mid-2016 (5 percent of bank lending to MSMEs) and the number of MSME beneficiaries from 750 to 5,500 (with some 3,000 investment projects).

This pillar also supports Morocco's broader financial inclusion policies. Financial inclusion—access and usage of quality financial services, including credit, savings, insurance, and transfer services— is central to the GoM's broader goal of modernizing the role of finance to promote private sector led development, particularly for low-income households and MSMEs. Morocco has delivered steady gains in financial inclusion and access owing to programs targeting small/young firms (guarantees, public-private co-investing and co-lending, BAM refinancing of MSME loans), low-income housing (guarantees), and lagging regions (postal bank, decentralization of guarantee agency, low-income banking, microfinance, and crop insurance). Upcoming milestones include reviewing the current ceiling on lending rates, updating the legal and regulatory framework for microfinance, and reducing the use of cash across the economy.

DPL2 will support the financing of young firms through measured aimed at supporting the financial restructuring of MSMEs, including reforming the secured transaction framework and putting forth conditions for paying VAT credits to MSMEs. The pillar will also further develop credit scoring for SMEs through supporting a second private credit bureau in Morocco. In addition, the pillar will advance financial inclusion amongst low-income households through extending the scope of electronic payments through non-bank service providers.

Pillar 2. Strengthen capital markets by improving the institutional framework and broadening the range of instruments.

In the context of DPL1 this pillar focused on deepening capital markets by broadening the range of instruments and investors. New instruments enable large borrowers to replace bank loans with market financing, thereby raising long-term funding more efficiently. Some market finance is possible in Morocco given the size of life insurance and pension funds. Some 70 stocks are listed, which requires a min of 25% float for the main market. Trading is focused on the large stocks. Banks and large corporates are issuers of commercial paper and bonds of various types, including residential-mortgage-backed securities or future-flow receivables. Due to the scarcity of these instruments, insurance and pension managers hold them to maturity. Capital market reform puts in place new instruments that enable the financing of infrastructure led by the private sector.[4] Pension reform is closely linked to this agenda, given adverse effects on capital markets should Morocco's large funds sell their assets to meet pension obligations.

Measures under this pillar include supporting the setup and operationalization of the independent capital market authority (*Autorité Marocaine du Marché de Capitaux - AMMC)*. This will assist in promoting financial stability and transparency by allowing the authority to license and certify financial professionals performing key roles in capital markets. The AMMC will have an independent sanction process, which will help ensure business conduct and investor protection in

[4] A modern Public Private Partnership Law came into effect in 2015.

line with standards in developed markets and provide an improved legal framework for investment services.

The pillar also supports the development of new capital market instruments by providing a legal framework for real estate investment trusts (REITs). Real Estate Investment Trusts (REITs) are a capital market instrument to finance commercial real estate. The MEF estimates that 3 percent of the stock of commercial real estate turns over per year, compared to 4 percent per week for mutual funds. Commercial real estate assets sitting on company balance sheets represent 15 percent of GDP. REITs are a means to liquefy these assets, while offering pension and insurance investors an asset class secured by real estate and yielding rental income. REIT-like transactions exist in Morocco, but are highly customized because they follow generic contract law. The proposed REIT law creates a dedicated framework that lowers costs, protects investors, regulates risk taking (leverage), and enables liquidity.

Pillar 3: Improve the financial sustainability of the Caisse Marocaine des Retraites.

Enacting pension reform will help ensure the continued development of local capital markets. Associated pension reform and capital markets is a link in a longer chain sustaining the social contract (delivering pension promises, minimum retirement income, and spousal survivorship). Current pension promises in Morocco are large by international standards, both high accrual rates and replacement rates. Overall pension assets stand at approximately 26% of GDP. As a result, all schemes are unsustainable to varying degrees, especially those burdened by adverse demographics—rising dependency ratio of beneficiaries to contributors. Actions supported by this DPL will continue supporting the reform of the *Caisse Marocaine des Retraites* (CMR-mandatory defined benefit regime for the civil and military services).

Pillar 4: Consolidating oversight to balance greater access with continued financial stability.

Safeguarding financial stability goes hand in hand with capital market reform. More instruments and investors has implications for macro-financial surveillance: (a) financial intermediaries disperse risks more widely, but regulators must ensure that investors in new instruments can bear the risks; and (b) the main intermediaries are part of conglomerates that comprise banks, asset managers, insurance, and nonfinancial activities.[5] As regulated financial intermediaries use capital markets more actively, regulators must continue to deliver effective consolidated supervision and develop recovery and resolution plans in an increasingly complex environment.[6]

The Parliament adopted the new Banking Law in December 2014 (prior action for DPL1). The law introduces a systemic risk council, a deposit insurance corporation, more direct intervention and resolution tools, and a supervisory regime for financial holdings. Three sets of implementing regulations have already been published.

---

[5] Moroccan financial conglomerates span finance, real estate, telecom, tourism. BAM also supervises *Caisse de Dépôt et de Gestion* (Government Investment Bank and Fund Manager), a state-owned conglomerate created by a 1959 law.

[6] This configuration poses risks that the authorities fully appreciate: the three banks have been designated as systemic, hence subject to tighter prudential rules; extension of perimeter of supervision to holding level; CSEs; establishment of systemic risk council that: (a) assesses system wide risks; (b) coordinates recovery and resolution of systemic institutions; and (c) jointly regulates financial conglomerates.

A prior action for DPL2 concerns regulations directing banks that belong to financial conglomerates to submit recovery plans. The central bank has issued draft regulations for technical consultations to the banks. The drafts would direct the three systemic banks to file recovery plans by June 2018, with the other banks filing a year later. The recovery plans (prepared by the banks and validated by the central bank) will be inputs into the resolution plans (prepared by the central bank based on the recovery plans). DPL2 also support the law on the central bank which designates BAM as the resolution authority and outlines minimum requirements for emergency liquidity assistance to banks.

IV. Poverty and Social Impacts and Environment Aspects

Poverty and Social Impacts

Reforms are expected to generate benefits for lower income households mainly through the 50% increase in minimum pensions, as well as job opportunities through economic growth and the development of financing solutions for SMEs. Reforms related to universal financial access, specifically extending the scope of electronic payments via accounts in non-banks, is expected to facilitate access to basic financial services among low-income households, thus improving welfare. The Government conducted consultations with stakeholders (financial institutions, donors, government authorities, industry associations, etc.) on Morocco's reform program supported by the Bank throughout the preparation of the DPL.

The design of the parametric pension reform has benefited from poverty and social impact analysis undertaken by several government agencies and international organizations and has been informed by a wide range of consultations with concerned stakeholders which the World Bank concurs with. The reform would improve social outcomes at the bottom of the income distribution for civil servants. Specifically, the increase in minimum pension will immediately improve the retirement income of 30,000 out of the current 230,000 retirees. The replacement ratio (retirement income/salary) of higher-earning employees who retire after 2016 will drop progressively from 87.5% of last salary to 81%, reflecting less generous accrual rates after 2016. Under the pre-reform pension plan, a 55 year old retiring at 60 with 35 years of contributions is eligible for a pension replacing 87.5 percent of his/her last salary, regardless of salary level. Post-reform, the same individual (now retiring at 63) would be eligible for a pension replacing 81 percent of salary, unless he/she earns less than 2000/month, in which case, the replacement rate actually increases gradually to 114 percent. It is estimated that, post-reform, some 30,000 retirees at the bottom of the wage distribution will have a replacement rate higher than the 87.5 percent of salary they enjoyed pre-reform. Some 24,000 will have a replacement rate between 81 percent (the new normal rate) and 87.5 percent. Any drop in the replacement rate will be progressive because the reform safeguards pension rights until 2016, with less generous parameters being phased in until 2022.

The civil service pension reform would also have positive spillovers for the wider population by supporting the income of urban families. Civil servants, both employees and retirees, overwhelmingly live in urban centers. Civil service employees represent 16 percent of contributors to pension funds in Morocco. The reform contributes to social stability in lagging pockets of urban centers by avoiding a large drop in the take-home pay of civil servants living in urban centers.[7] For their part, retirees of the civil service currently receive 43 percent of total pension benefits in Morocco. The reform safeguards also their income and contributes to social stability in urban centers, especially as the number of civil service retirees will exceed 400,000 by early next decade compared to 230,000 in 2016.

Women are specific beneficiaries of reforms supported by DPL2. Financial sector development is particularly relevant for female economic empowerment because it creates opportunities for business expansion and productive investment at the household level, by passing many socio-economic barriers that prevent women from participating in the economy. The operation's gender-impact will consist of: (a) financing for women-led MSMEs, including through the opening of CCG branches in lagging regions; (b) expanding electronic payments; (c) improved credit information systems including a secured transactions framework that empirically has shown to benefit women entrepreneurs who may not own land to provide as collateral; and (d) pension reform. The pension reform will be gender positive by: (a) replacing final salary with an average will benefit women as men tend to have steeper career paths; and (b) the reform safeguards survivorship pensions, as women represent 99 percent of survivorship beneficiaries and survivorship pensions represent 40 percent of pensions by number.

Environment Aspects

Increased access to finance for MSMEs is not expected to have material environmental impacts. Environmental risk is managed through three main transmission channels under the operation. First, the GoM's environmental legislation and associated country systems and administrative responsibility are found to be sound. Over the last decade, the Government has made progress in establishing a full-fledged environmental legislation and articulating the different layers of the administration responsible for monitoring its implementation. Law No. 12-03 of 2003 and its implementing decrees defined the requirements for Environmental Impact Assessments (EIAs) and created review and oversight structures for implementation, such as national and regional EIA committees, and procedures for public consultation and disclosure. The monitoring and control framework was recently strengthened through the creation of national and regional observatories for environmental protection, and the establishment of an environmental police corps. The Government intends to broaden the scope of application of the EIA Law to other projects to further strengthen its scope, in particular in relation to the treatment of cumulative impacts of investments, in addition to the requirement for environmental assessments of sector programs and policies.

Secondly, the five largest Moroccan banks have participated in a training program on environmental and social risks within the framework of the World Bank-funded Morocco MSME Development Project which provides partial credit guarantees for loans to MSMEs. Third, the operation benefits from IFC protocols to screen and mitigate environmental impacts. In Morocco IFC is engaged in investment projects (both debt and equity) with leading banks and microfinance institutions that account for the majority of SME lending. This includes one of the largest banks in the MENA region and the three largest microfinance institutions accounting for over 89% of total microloans in the Kingdom. These investments follow a rigorous due diligence process based on IFC's performance standards on social and environmental sustainability. IFC

[7] 80% of the unemployed live in urban centers, of which 650,000 are 15-29 years old, 300,000 of which are university graduates.

uses a categorization process to reflect the magnitude of risks and impacts. If areas of improvement are identified, specialists work with the client to develop action plans and concrete deliverables and timelines, which are incorporated into a loan or investment package. This mitigation planned is supported through ongoing implementation support and embedded monitoring and evaluation for continuous mitigation of environmental impacts of their clients' investments.

V. Tentative financing

Source:		($m.)
Borrower		0.00
International Bank for Reconstruction and Development (IBRD)		450.00
Borrower/Recipient		
Others (Specifiy)		
	Total	450.00

VI. Contact point

World Bank
Contact: Gabriel G Sensenbrenner
Title: Lead Financial Economist
Tel: (202) 473-6266
Email: sensenbrennerg@worldbank.org

Borrower
Contact: Faouzia Zaaboul
Title: Head of Treasury and External Relations
Tel: (212) 6-61-29-15-48
Email: f.zaaboul@tresor.finances.gov.ma

VII. For more information contact:

The InfoShop
The World Bank
1818 H Street, NW
Washington, D.C. 20433
Telephone: (202) 458-4500
Fax: (202) 522-1500
Web: http://www.worldbank.org/infoshop