PROGRAM INFORMATION DOCUMENT (PID)
CONCEPT STAGE

March 8, 2016

Report No.: AB7824

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	March 8, 2016
Estimated Date of Appraisal	May 9, 2016
Estimated Date of Board Approval	July 14, 2016
Corporate Review Decision	Following the corporate review, the decision was taken to proceed with the preparation 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 SME Finance Development Policy Loan to the Kingdom of Morocco (DPL2) in the amount of US $300 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 series builds on several years of engagements and strong Government ownership of the program, as shown by reforms implemented supported by both DPL1 as well as ongoing technical assistance provided by the World Bank Group to Morocco's financial sector authorities.

Morocco recently achieved further consolidation of its macroeconomic framework. Public finances continued to improve in 2014 thanks to a substantial cut to fuel subsidies. The external position benefited from low oil prices, resilient tourism receipts, higher remittances and increased foreign direct investment. Medium-term prospects will depend on the continuation of sound macroeconomic management, diversifying export products and destinations, and maintaining FDI attractiveness.

The Government of Morocco (GOM) recognizes that economic competitiveness and resilience depends on a well-functioning market for capital through more diversified financial intermediation. The financial sector is well-positioned to address development challenges by modernizing the market for capital. The sector is large and diversified:[1] 24 banks (2 foreign-owned), 1 postal bank, 18 insurers, four large pension funds, 373 mutual funds, 35 finance companies[2], 13 microcredit institutions, and 2 state-owned specialized financial groups. The GOM's Program aims at a new mixture of banking and capital markets to better finance the real economy, while safeguarding financial stability. The proposed operation (DPL2) supports this Program through its focus on the legal and regulatory framework for developing local capital markets, pension reform, access to finance for small and young firms, and upgraded oversight of financial intermediation.

The proposed DPL2 complements: (i) the World Bank Group's (WBG's) Economic Competitiveness Program which supports modernizing the functioning of markets for goods and services (trade facilitation, competition policy, investment climate); (ii) the Skills and Employment DPL that supports the better functioning of the market for labor and skills; and (iii) the Transparency and Accountability series, to upgrade the governance of state-owned enterprises, procurement policies, and public services to the business community.

The proposed DPL2 supports pillar one of the new WBG strategy for the Middle East and North Africa (MENA) region (renewing the social contract) through promoting a diverse and resilient financial sector that responds to the needs for financing the real economy, financial inclusion and access. A better functioning market for capital helps generate jobs by allocating scarce resources efficiently and allowing dynamic firms to grow. Financial inclusion promotes welfare by helping households and SMEs manage saving and investment, and respond to shocks.

II. Proposed Objective(s)

The proposed operation is the second in a programmatic series of two DPLs. The programmatic option recognizes the medium term nature of the reforms and the fact that the reforms run the length of the current Parliament (2011-16). The project development objectives of this DPL are to:

- Deepen capital markets by broadening the range of instruments and investors;
- Reform pension system as a key investor;
- Foster solutions for the financing of small and young enterprises;
- Consolidate oversight to balance greater access with continued financial stability.

III. Preliminary Description

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 consultations also led to dropping two prior actions envisaged in 2014 and finding replacements. Changes in results indicators recognize the experience gained in the

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[1] Banking: 130% of GDP; asset management: 30%; pension funds: 25%; insurance: 20%; other NBFIs: 10%.
[2] Finance companies extended 14 percent of total loans in 2014 (60%: households; 40%: corporates).

implementation of reforms supported by DPL1, as well as a large, multi-year funded set of advisory and analytical work currently ongoing.

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

Development Objective 1. Deepen capital markets by broadening the range of instrument and investors in the overall financial system. 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 line with standards in developed markets. The pillar also supports implementing an updated securities lending framework and supporting regulations for the trading and clearing of derivatives.

Development Objective 2: Reforming Morocco's pension system to ensure continued institutional demand for capital market securities. Current pension promises in Morocco are large by international standards, both high accrual rates and replacement rates. 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 would continue supporting the reform of the *Caisse Marocaine des Retraites* (CMR-mandatory defined benefit regime for the civil and military services).

Development Objective 3: Fostering solutions for the financing of small and young enterprises. In the GOM's Program, policies fostering new financing solutions for small and young enterprises supplement capital market reforms, as market finance is unsuited for most such firms. Morocco leads in the region in SME access. Bank lending, however, still focuses on larger SMEs with more readily pledgeable collateral[3] The GOM helps banks go down-market via guarantees and co-investments by the Credit Guarantee Institution (CCG), an agency funded by the general budget. CCG has recently adapted its products to leverage banks' strategies towards SMEs: over the past ten years, it increased its financing of SMEs and sole proprietorships (*entrepreneurs individuels*) from 2% of bank credit to such borrowers to 5%. Adopting the 2013-16 CCG strategy was a prior action for DPL1. The second DPL series will support the financing of young firms through reforming the secured transaction framework and providing innovative financing solutions for start-ups. This includes the design and implementation of a public-private fund for co-investments managed by the CCG. The pillar will also further develop credit scoring for SMEs through supporting a second private credit bureau in Morocco.

Development Objective 4: Consolidating oversight to balance greater access with continued financial stability. This DPL will support improved oversight over financial conglomerates through supporting new regulations that would extend the perimeter of supervision to the ultimate corporate owners of banks. In Morocco systemic banks are owned and controlled by holdings that also control commercial and industrial entities, hence the banks are part of mixed

[3] See World Bank Research Paper 5607 "Bank Lending to SMEs in MENA: A Joint Survey by Union of Arab Banks and World Bank."

conglomerates. This has two implications for financial stability: a. losses in the non-financial parts of the conglomerates could compromise the financial strength of ultimate owners of banks; b. the banks are systemic.

IV. Poverty and Social Impacts and Environment Aspects

Poverty and Social Impacts

Reforms are expected to generate benefits for lower income households mainly through pension reform, as well as job opportunities through economic growth and the development of financing solutions for SMEs.

With regards to pensions, the reform of the CMR will help avoid pension-related budgetary spending from crowding out key social programs in health or education. The implementation in the coming years of a “two-pole” pension system and, later on, broadening coverage, is also expected to improve social outcomes.

With regards to financing solutions for SMEs, the development of credit scoring products for SME and microfinance borrowers will facilitate access to finance of credit constrained enterprises, thereby increasing the potential for job creation in the private sector and better social outcomes.

Measures supporting improvements in the supervisory structure of financial conglomerates will promote financial stability, which will promote the efficient allocation of capital to promote ongoing investment and private sector expansion in Morocco. This will help advance economic outcomes and as a result reduce poverty and contribute to maintained social cohesion in the Kingdom. Consultations on Morocco’s reform program supported by the Bank were conducted with stakeholders (financial institutions, donors, government authorities, industry associations, etc.) throughout the preparation of the DPL I and II. The Government remains committed to monitoring the impact of all key reforms and economic events on poverty and social outcomes.

The gender impact would be indirect and consist of: (i) new financing solutions for women-led SMEs under the strategy of the CCG, including through more branches in Morocco’s regions; (ii) pension reform. The pension reform will be beneficial for women, notably through the planned introduction of explicit indexation rules. With life expectancy longer than men, indexation will mean better preservation of the purchasing power of women pensions. The move away from final salary to average will also benefit women, as men still have steeper career paths. Finally, the reform will preserve very generous existing survivorship pension promises: beneficiaries of survivorship pensions represent around 41 percent of all beneficiaries in CMR, and women represent 99 percent of survivorship beneficiaries.

Environment Aspects

This operation supports a broad program of policy and institutional reforms, for which the requirements of OP/BP 8.60 apply. Over the last decade, the Government has made progress in establishing a full-fledged environmental legislation and articulating the different layers of the administration supporting it. Law No. 12-03 of 2003 and its application decrees defined the requirements for Environmental Impact Assessments (EIAs) and created review and oversight structures for implementation, such as national and regional EIA committees, as well as 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 (OREDD), and the establishment of an Environmental Police corps. The Government intends to broaden the scope of application of the EIA Law to other projects in order to further strengthen its scope, in particular in relation to the treatment of cumulative impacts of investments, in addition to the requirement for Strategic Environmental Assessments of sector programs, policies and strategies.

Increased access to finance for SMEs is not expected to have material environmental impacts. 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 SMEs. In addition, the IFC holds equity stakes in banks that account for the majority of SME lending. These banks therefore follow rigorous protocols to screen and mitigate environmental impacts of their clients' investments.

V. Tentative financing

Source:		($m.)
Borrower		0.00
International Bank for Reconstruction and Development (IBRD)		300.00
Borrower/Recipient		
Others (Specifiy)		
	Total	300.00

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