Financial market development, policy and regulation: the international experience and Ethiopia’s need for further reform

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Chapter 6
Summary and Conclusion

The questions for this research were the following:

1. What do the current structure, operation, policy and regulation of the financial market in Ethiopia and the reforms in the past look like?

2. a. Is there need for further reform of the structure, policy and regulation of the financial market in the country and what should the reform be, if any?
   b. What are the lessons that can be drawn from the international experience and recommendations in this respect?

The chapters have discussed the history, current state, structure, policy and regulation of the financial market of the country and shown that there are needs for further reform in light of both the international experience and recommendations and the domestic situation. The second chapter has discussed these and indicated the measures that need to be taken in respect of the existing banking, insurance and microfinance markets and institutions in the country. The third and fourth chapters have made the discussions in respect of the future securities market and private pensions and indicated the needs and measures that need to be taken to create these markets and institutions in the country and design their structures and regulations. The fifth chapter has discussed the regulatory enforcement mechanism in respect of both the existing banking, insurance and microfinance markets and institutions and the future securities market and private pensions and indicated the measures for further action. The following sections gather the major findings and the measures that need to be taken by the country. The last section indicates the general lessons that can be drawn from the chapters and which need to be taken into account by the country in pursuing the financial market regulatory reform.

6.1 The Development, Policy and Regulation of the Banking, Insurance and Microfinance Markets

i. The International Experience

The developed market countries have used their banking and insurance regulations to:

- enforce monetary policy objectives;
- promote domestic and international competition;
- enhance efficiency;
- maintain financial stability and security;
- protect consumers;
- encourage information flow and prudential decision making; and
- achieve general economic and social policy objectives.

Their use of the regulations to achieve the last set of objectives has, however, declined through time. They enforce this set of objectives through financial regulation only when the objectives are determined outside the realm of monetary and financial policy and can be coordinated with it.

The transition and emerging market countries of Asia, Latin America and Africa have also tried to target their banking and insurance policies and regulations at the aforementioned types of monetary and financial policy objectives although with difference on prioritization. The reasons of their regulations have come from the very nature of the financial markets and businesses, the development objective, and the dynamics of their transitions to free market. Hence, they have used their regulations to:

- develop their financial markets;
- expand and disseminate the financial services;
- achieve monetary policy goals;
- promote competition;
- enhance efficiency;
- encourage information flow;
- prevent and contain systemic failure;
- create the conditions for economic development; and
- enforce goals that are contributory to their transitions to free market.

They have also used their microfinance regulations to encourage expansion of service, enhance financial inclusion of the poor, promote commercial business approach, mitigate the risk of failure of the microfinance institutions, protect consumers, and create the conditions for economic development.

The BCBS and IAIS have also encouraged them to prioritise and enforce objectives similar to the ones promoted in the developed market countries according to the preconditions for effective enforcement that can be available in their domestic situations.

Both the developed and the transition and emerging market countries also subject their banks and insurers to varieties of market entry, ongoing, and exit requirements. They subject them to prudential, competition, market conduct and systemic stability related requirements despite variation on technicalities and the specific rules and instruments they endorse. The prudential regulations include licensing, capital adequacy, reserving, accounting, valuation, liquidity, solvency, functional and ownership separation, risk diversification, risk transferring, information exchanging and fund guarantee requirements. The competition regulations include prohibitions of anti-competitive mergers, agreements and practices, and abuse of dominant positions that are often done through the general competition laws and sometimes through financial market specific rules. The market conduct regulations include regulations of insider dealing and market manipulation, regulation of contract terms, regulation of product distribution, regulations of governance and auditing, and requirements of information disclosure. The systemic stability regulations include interest, foreign exchange and premium regulations, payments and settlement systems oversights, emergency liquidity support rules, lender of last resort measures, and failure resolution mechanisms.

They also subject the microfinance institutions to regulations that are more or less fashioned like the regulations of the banking and insurance markets with difference on technicalities and strength of regulation due to the special characteristics of the microfinance operation and institutions.

The BCBS and IAIS also recommend that the banking, insurance and microfinance market regulations in the countries need to use the aforementioned varieties of instruments based on their local contexts.

The 2008 financial and economic crisis has also indicated that the major goals of regulations of the modern financial markets need to be prevention and containment of systemic failure (i.e. assurance of financial stability) and protection of consumers and investors. It has also shown that the aforementioned varieties of instruments of regulation need to be strengthened in order to increase their risk prevention and containment ability, enhance the protection of consumers and investors, and balance between the achievement of these and the other goals of financial regulation. The recent recommendation regarding microfinance regulation is also towards further balancing between the objectives of expanding availability and increasing the benefits of microfinance, on the one hand, and promoting the commercial business approach (i.e. competition), enhancing sustainability, preventing failure, and protecting consumers, on the other.

ii. The Case of Ethiopia

Ethiopia has conducted financial sector reform following the change in government and economic policy in 1991. It has re-established the National Bank of Ethiopia (NBE) as central bank and financial market regulator and opened the banking and insurance sectors for domestic private investment through monetary, banking and insurance supervision laws that are enacted in 1994 and amended in 2008. It has made inter-bank money and foreign exchange markets operational as of 1998. It has also introduced a regulatory regime for microfinance, required the formal establishment of the microfinance institutions within the financial system, and required the NBE to promote development of the traditional savings institutions of the society along with the microfinance institutions and to encourage participation of the banks and other financial institutions in the provision of microfinance by a law enacted in July 1996 and amended in 2009. It currently subjects the banks, insurers and microfinance institutions to supervision laws that are similarly fashioned and complementary to one another. It also allows the transformation of the microfinance institutions into formal banks and the direct engagement of the formal banks and insurers in the provision of microfinance. It has licensed twelve private banks, eleven private insurers, thirty microfinance institutions and more than one thousand insurance auxiliaries under this regime. There are also government owned three banks and one insurer.

The country has not, however, achieved desirable level of banking, insurance and microfinance services. All the services are at their beginning stage of development and a substantial size of the Ethiopian population still lives without them. The banks, insurers and microfinance institutions are also weak in their fixed capitals, service types, governance and competitiveness. They have not diversified, modernized, automated and networked their services. The banks, other than the Development Bank of Ethiopia, also concentrate on short and medium term trade finance while the insurers concentrate on short term general insurance making the total long-term insurance less than six percent of the total insurance business in the country. The microfinance institutions also concentrate on short-term deposit taking and lending with very small section of the society despite their extensive authorization to stimulate the development of micro and small scale operations. All these, added to the absence of formal securities market and private pensions in the country, have also made the country lack dependable domestic long-term finance. The payments system of the country has also remained largely to be based on the cash mode of payment. The country needs to improve on all these.

The banking, insurance and microfinance supervision laws of the country do not also define and prioritize their specific objectives. The NBE does not also link its directives and regulatory measures to specific objectives consistently in practice. The country does not also have comprehensive financial regulatory policy which defines and prioritizes between the specific objectives of the banking, insurance and microfinance regulations. The objectives of regulation are, therefore, only inferred in practice from the powers and objectives of the NBE as central bank, the monetary policy framework of the NBE, the country's general economic policy, and the pieces of principles included in the competition and other laws of the country.

The country needs to define and prioritize the specific objectives of its regulations in the supervision laws clearly and the NBE needs to link its directives and regulatory measures to the specific objectives consistently so that there will be no overlooking and abuse of regulation during enforcement. This will also enable the financial institutions, consumers and stakeholders to clearly know about the reasons and objectives of financial regulation, appreciate the importance and legality of the instruments used, and contribute to the enforcement of regulation.

Being a transition economy heading to free market, the country needs to take into account the experience of both the developed and the transition and emerging market countries and make the objectives like the ones in the latter. It needs to link the regulations to the following objectives:

- developing the markets;
- disseminating, diversifying and modernizing the financial services;
- promoting competition, efficiency and innovativeness in the financial system;

- maintaining financial market health, stability and security;
- preventing systemic failure;
- protecting consumers, the public and the economy from abuse and financial failure;
- increasing information disclosure and prudential decision making;
- meeting monetary policy objectives; and
- achieving economic and social policy objectives contributory to its development and transition to free market.

It, however, also needs to learn from the international experience and enforce the last set of objectives through the instruments of financial market regulation by formulating them outside the realm of monetary and financial policy and to the extent that they can be coordinated with the other objectives of financial regulation. It also needs to enhance the competition regime for the financial markets and enforce the other objectives of regulation without endangering the competition objective.

The monetary policy of the country also needs to continue to focus on the objectives of controlling inflation, influencing the cost and availability of financial services, maintaining price and exchange rate stability, and achieving balance of payments equilibrium since these are ongoing problems in the country.

The current banking, insurance and microfinance regulatory instruments of the country also have elements from the international experience. They have also evolved through time. A number of them are, however, incomplete, restrictive or inappropriate to the domestic situation and needs of the country. Several of them do not also comply with the latest recommendations of the international organizations (including the BCBS and IAIS) in terms of both content and enforcement. They fail much in their risk orientation, use of corporate governance techniques, and enforcement infrastructure. They need to be improved. The following need to be done among others:

1. The licensing regulation needs to be improved to:

- promote geographic diversification of branching;
- decentralize the formation of banks, insurers and microfinance institutions to the regions with regulation by the NBE from the centre and one-stop-shop service of the NBE at the regional state level;
- remove the licensing and prior permission requirements for branching and change of place of business and focus on regulation of the overall health of the financial institutions;
- fix maximum number of branching or branching ratio in the law to restrain the further expansion of the largest banks, insurers and microfinance institutions in order to i) make them concentrate more on efficiency and competitiveness than on size and ii) correct the existing market dominance.

- make clear distinction between the initial capital requirement for market entry and the ongoing capital adequacy requirement for operation in the banking and microfinance supervision laws and enforcement;
- fix the initial capital requirements on the banks and microfinance institutions in the law (as in the case of the insurers) and leave the ongoing capital requirements on both institutions to decision of the regulator (i.e. the NBE);
- make the ownership spreading requirements on the banks, insurers and microfinance institutions less restrictive on investment choice and ability of the financial institutions to raise capital;
- make the NBE exercise pre-business commencement examinations on applicants for license in order to make sure that the disclosures and proposals made by the applicants are appropriate and practical;
- remove the licensing rules that require the insurance auxiliaries to start afresh annually;
- list the grounds for license refusal and make the obtaining of license legal right expressly;
- regulate the procedure of licensing by requiring the NBE to adhere to principles of administrative law including the conduct of hearing, the reasoning of decisions, the making of decisions transparent, and the proper handling of complaints during licensing;
- increase the speed of licensing;
- require the NBE to keep register of licensees in which it has to record the particulars about the licensees that are useful for the conduct of prudential and other supervision; and
- remove the annual license (and registration) renewal requirement from the financial regulatory regime and allow the NBE to focus on the use of the license revocation and other instruments for its prudential regulation.

2. The nationality requirement needs to be reconsidered so that the country will:

- give attention to the roles foreign financial institutions can play in the enhancement of competition and the development of the quality and types of the financial services;
- build its regulatory and market capacities;
- open the financial market for foreign investment gradually and in a way that will not necessitate capital account liberalization until it becomes able to absorb international risks; hence, following the steps of:
    - first, develop fiscal and monetary control (i.e. limit government spending, have broad based tax system, reduce tax rates, control inflation, and stabilize prices);
    - second, enhance banking, insurance and microfinance regulation and develop domestic capital market (with institutional investors and the necessary regulation);
    - third, liberalize the banking and capital markets without opening up of the international capital account; and
    - fourth, open the international capital account and allow free convertibility of foreign exchange;

- make the liberalization to the financial institutions of the countries with which it has the largest trading relation (until it becomes member to the WTO and liberalizes fully under the GATS); and
- design a regulatory system that can discourage the potential problem of hit and run and encourage the contribution of the foreign financial institutions to the development of its financial system.

3. The capital adequacy, reserving, provisioning, liquidity and solvency regulations need to be improved to:

   - relate all the ongoing capital adequacy requirements to risk types in accordance with recommendations of the BCBS;
   - require the insurers to maintain a risk weighted capital adequacy level in the fashion this is done for the banks and the microfinance institutions and in accordance with the international recommendations of the IAIS, and thereby ensure the continued growth of the risk absorption capacity, competitiveness and stability of the insurers;
   - include liquidity rules in the solvency requirement on insurers in accordance with recommendation of the IAIS; and
   - make the NBE take into account the compliance situations of the banks, insurers and microfinance institutions in setting the reserving and provisioning requirements.

4. The accounting, balance sheet and valuation rules need to be improved to:

   - expressly prohibit the creation of hidden reserves through undervaluation of assets and overvaluation of liabilities; and
   - standardize and enact the accounting and valuation rules which the banks, insurers and microfinance institutions have to follow instead of making general reference to internationally accepted accounting principles.

5. The functional and ownership separation regulation needs to continue to separate the banking, insurance, microfinance, securities, pension and other markets in the short run and the case for financial market conglomeration needs to be considered in the long run in order to make the financial market consistent with the international experience as the banking, insurance, microfinance, securities and pension markets grow.

6. The risk diversification regulation needs to be improved to:

   - make the rules on investments of the financial institutions less restrictive; and
   - set regional, sectoral and deposit diversification requirements that will enhance both the diversification of risks and the dissemination of services of the financial institutions.

7. The risk transferring regulation needs to be improved to:

- require the commercial banks and microfinance institutions to insure themselves against the insurable risks associated with their operations;
- regulate the terms and conditions of collaterals of the banks and microfinance institutions in order to prevent abuse and enhance prudence;
- require the insurers to re-insure a defined threshold of their liabilities; and
- promote and regulate the undertaking of domestic re-insurance.

8. The information acquisition and exchange regulations need to be strengthened to:

- require and empower the credit recording and information exchange centre at the NBE to collect, record, analyse and disseminate information on the general financial circumstances of borrowers on top of the indebtedness reports from the banks;
- make the insurers and microfinance institutions members to the credit recording and information exchange centre at the NBE;
- subject the businesses in the non-financial sector to accounting and auditing requirements as part of the effort to formalize and regulate them and the financial services; and
- require the banks and microfinance institutions to review the financial statements of all the businesses before they extend credit facilities of any size to them.

9. The competition regulation needs to be improved to:

- fully enable the making of market based interest and foreign exchange rates by the banks and microfinance institutions;
- take measures against the conscious parallelism of the banks and insurers and the market division tendencies of the microfinance institutions;
- correct the market dominance already created in the financial market and strictly enforce the general competition law rule that prohibits the creation of market dominance;
- enhance competition by imposing geographic diversification requirements;
- make the banking, insurance and microfinance markets more contestable;
- permit foreign competition;
- enforce codes of conduct and incentives for competitively desirable behaviours; and
- adopt specific rules for the financial market that will remove the shortcomings in the general competition law regime (such as the non-definition of market share, non-regulation of anti-competitive merger, non-determination of choice between the per se and the rule-of-reason approaches, and non-proactiveness of enforcement) until the general competition law and enforcement are improved to remove these shortcomings.

10. The insider dealing and market manipulation regulations need to be improved to:

- make them applicable on all insiders and secured and unsecured loans of all the financial institutions, and
- balance between the interests of controlling abuse and promoting competition.

11. The contract terms regulation needs to be strengthened to cover not only the long-term insurance contracts but also the general insurance, banking and microfinance contracts.

12. The product distribution regulation needs to be improved to:

- remove the rule that restricts the introduction of new services by the banks by a requirement of prior authorization by the NBE;
- include product diversification, automation and networking and regional and sectoral service distribution requirements; and
- make the product distribution regulation applicable on all the financial institutions and auxiliaries.

13. The governance and auditing regulations (and the licensing requirements related to them) need to be improved to:

- set the minimum standards and principles for governance and auditing in line with the international recommendations of the OECD, IFAC and others;
- avoid the use of restrictive governance rules (such as the requirements on office terms of members of the boards of the banks);
- make the managerial qualification and experience requirements more stringent than they are now and applicable on all the managers other than the chief executives of the financial institutions;
- make the limits on outside managerial engagement applicable on all members of the boards of directors, executives and managers of all the financial institutions and ensure undivided attention of the leadership of all the financial institutions;
- set maximum age limit on the board members, executives and managers of the financial institutions and enhance governance quality;
- institutionalize capacity building program and a national testing or certification centre which will examine, and check continuity of, the competence of existing and future leaders of the financial institutions;
- make the supervision departments of the NBE consider the legality, need and feasibility of the instruments they use whenever they implement requirements on the shareholding and leadership of the financial institutions;
- allow participation of employees and stakeholders in the governance of the financial institutions in line with the international recommendations;
- strengthen the financial criminal tracing mechanism and bar all criminals and unreliable persons from managing and owning the financial institutions; and

- make the NBE follow a proactive as opposed to reactive approach of regulation in order to make the banks, insurers and microfinance institutions improve on their limitations.

14. The information disclosure regulation needs to be improved to:

- require the banks, insurers and microfinance institutions to make sufficient, reliable and timely reporting and disclosure of all information not restricted by law;
- require the NBE and the financial institutions to automate the off-site reporting processes;
- require the NBE to publish its supervisory reports to the public except for information restricted by law;
- define the information that should be restricted from public disclosure for the reason of privacy or public interest; and
- encourage the creation of information processing and rating agencies that will assist the pubic disclosure of information.

15. The interest, foreign exchange and premium regulations need to be improved to:

- encourage the NBE to continue to shift its roles from direct to indirect controls of interest, foreign exchange and premium;
- make the interest, foreign exchange and premium determinations market based;
- urge the NBE and the banks, insurers and microfinance institutions to build their interest, foreign exchange and premium risk absorption capacities;
- make the premium regulations applicable on the premiums of both the long-term and the general insurers; and
- formalize and regulate the hitherto existing informal foreign currency exchange market which is often known as black or parallel market.

16. The payments and settlement systems regulation needs to be improved to:

- make the NBE and its supervision departments act proactively and work with the banks and other financial institutions in order to develop the national payments and settlement systems;
- require the banks, insurers and microfinance institutions to plan and work on modernization of the country's payments and settlement systems (including the spread of commercial instruments and development of electronic payment and settlement systems) more actively than they do now; and
- upgrade the Cheque Clearing Office in Addis Ababa to a National Clearing Office to facilitate the use and clearance of all commercial instruments across the financial institutions as long as these instruments continue to be important.

17. The fund guarantee, liquidity support, lender of last resort and state ownership regulations need to be improved to:

- subject the banks, insurers and microfinance institutions to fund guarantee and deposit insurance requirements;
- enable (and require) the NBE to exercise the role of lender of last resort during crisis situation;
- establish (and regulate the scope, nature and adverse effects of) the deposit insurance, fund guarantee and lender of last resort schemes according to international experience;
- enhance the use of the current inter-bank lending and emergency liquidity support schemes for temporary illiquidity problems;
- build the problem resolution capacity of the NBE; and
- remove government ownership of the banks, insurers and microfinance institutions in the long run and gradually and focus on the use of indirect instruments of regulation.

6.2 The Development, Policy and Regulation of Securities Market

i. The International Experience

The Netherlands, Germany, France, UK, Ireland, Portugal and New York have created the Amsterdam, Frankfurt, Paris, London, Irish, Lisbon and New York exchanges in the 17th and 18th centuries. A number of the other developed and some Latin American, Asian and African countries have created and developed their securities markets in the 19th and 20th centuries. A number of the transition and emerging market countries of Eastern Europe, Asia, Latin America and Africa have also introduced securities markets after they have adopted their free market policies in the late 1980s and thereafter.

Most of the developed market countries have also enhanced the activities of their securities markets through reforms implemented as of the late 1980s. They have lowered transactions costs, introduced negotiated (as opposed to fixed) commission systems, replaced the open outcry and call methods of trading by electronic systems, opened up the membership and listing of the exchanges to domestic and foreign investors, encouraged the participation of institutional savers and market makers, and internationalised the markets by the reforms. They have also shifted from an exchange-as-public market to an exchange-as-firm approach and incorporated the exchanges as competing demutualized companies (i.e. as companies with profit goal and separate ownership, membership and governance). They have also introduced electronic clearing and settlement systems and required the dematerialization and central custodian of securities as technology grew. They have also organized the exchanges to serve as market places for both government and private and small and big company securities. Germany and Japan (which used to rely much on bank based finance system) have also increased the roles of their securities markets in the same period.

The transition and emerging market countries have also followed the trend by incorporating and demutualizing their exchanges, dematerializing securities, centralizing the clearing, settlement and custodian services, and automating the exchanges and the clearing and settlement services. Some of them have also required incorporation of the securities market intermediaries as dealer or broker companies with capital and employment of the individual market actors by these companies. They have also encouraged the exchanges to have market wings for government and private and small and big company securities.

Both the developed and the transition and emerging market countries have also made the protection of investors, reduction of systemic risk, and development of efficient, fair and transparent market as the major objectives of their securities market regulations.

They have also implemented securities market laws that mix merit and disclosure regulation and require the exchanges, intermediaries, collective investment schemes, and securities custodian, clearing and settlement institutions to meet initial and ongoing financial and non-financial requirements to meet these objectives. They have required them to meet requirements on company form, initial capital, qualification, professional integrity, capital adequacy, reserving, fund guarantee (or insurance), accounting, auditing, reporting, public disclosure and other corporate governance matters. They have also introduced rules that restrain trading outside the recognized exchanges; require all the securities intermediaries to be members of the recognized exchanges; sanction insider trading, price manipulation and fraud; allow follow up, suspension and cancellation of trading; enable the ongoing supervision of collective investment schemes and listed companies; and require provision of the securities custodian, clearing and settlement services by centrally incorporated companies. The countries that used to rely much on self-regulation (such as UK, the Netherlands and New Zealand) have also revised their approaches and increased governmental regulation.

ii. The Case of Ethiopia

Ethiopia had a securities market in the 1960s and 70s. The market was closed because of change of policy in 1974. The country does not have a securities market currently. It has created only an agricultural commodity market which is owned fully by the government and operated outside the financial market.

The creation of securities market is justified in the country by the following functions:

- providing long term finance which the banks are not doing;
- meeting the growing need for domestic resource to finance investment;
- providing market place and thereby enhancing the transferability, liquidity and proprietary value of existing securities;
- curing the excess reserve and liquidity positions of the banks;

- enabling the NBE to enforce monetary and financial policy objectives through indirect and open market instruments;
- encouraging the creation of institutional savers and investors, diversifying the financial market and increasing competition;
- motivating companies to go public and widen their ownership bases;
- enhancing information flow and corporate management, accounting and control;
- assisting individuals, households, business firms and the financial institutions to diversify their income and investment portfolios; and
- facilitating future privatisation.

It, however, also faces challenges including the following:

- short track record of the share companies in the country to attract buyers for their securities;
- reluctance of a number of the companies in the country to go public and freely float their securities;
- lack of separation of ownership and management of most of the share companies in the country;
- lack of financial and investment experience and conservative attitude towards money of most members of the business community;
- little experience of mangers of companies in corporate portfolio management and underdevelopment of the accounting and auditing professions;
- more attention of the investment regime and practice of the country to direct investment than portfolio investment through company securities;
- non-issuance of shares other than ordinary shares by the share companies, including the banking, insurance and microfinance companies that could take the lead in the issuance and trading of securities;
- low level of the income and saving of most individuals and households to establish dependable demand for securities;
- fragility of the macro and political situation of the country to attract investment and enable sufficient supply and demand for securities;
- lack of capacity of the financial regulator (the NBE) to provide strong supervisory framework for a securities market; and
- failure of the tax regime of the country to encourage creation of securities market.

These challenges do not, however, justify retreat from creation of the securities market since many of them are results of either the hitherto absence of the securities market or government policy itself. Most of the other countries of the world have also developed their securities markets in the presence of these types of challenges (and sometimes market crashes) and the country needs to learn that the creation of securities market can happen in the presence of challenges. They, however, indicate the magnitude of the problem the country has to face in creating and developing the securities market.

Ethiopia also needs to learn from the history of its own share market of the 1960s. This market originated in the absence of dependable number of companies, experience on public offering, and a law that would regulate it. It was, however, successful until it was closed because of policy change in 1974.

The country need not also be in fear of the perceived problems of regulatory incapacity, pressure for rapid liberalization, and economic crisis due to rapid in and outflow of foreign capital. First, the international experience also shows that regulatory capacity is something that grows along with development of a market. Secondly, the international community has become cognizant of the need for gradual liberalization of financial markets and control of the potential problems of huge capital inflow, economic overheating, sudden repatriation and crisis through prudential regulatory requirements and capital transfer controls until full liberalization is viable. Thirdly, international portfolio investment is made these days through internationalised depository certificates that have to be managed by international custodian companies and Africa's experience shows that only few international investors are interested in portfolio equity investment in the continent despite the development of securities markets with elimination of foreign exchange controls, removal of restrictions on foreign participation, and institutionalisation of securities custodian services. Ethiopia's investment data also shows that domestic investment is much more significant than foreign investment and it is unlikely that the situation will change suddenly as the country creates the securities market. The 2008 financial and economic crisis has also slowed down the flow of international capital to developing countries and it is unlikely that huge capital inflow and sudden repatriation (hence, crisis) will occur in the near future.

The country need not also make the creation of corporate bond market condition precedent to creation of the fully fledged securities market. This is not valid given that there are no corporate bonds issued and circulated in the country while there are lots of equity shares and outstanding government bonds that can be circulated in a fully fledged securities market.

Hence, the country needs to create the market and do the following in designing its structure and regulation.

1. It needs to design the market and its regulation based on the exchange-as-firm approach in line with the international trend; make the market structure consistent with the structure of the existing banking, insurance and microfinance markets; and align the regulation with the international approach in order to benefit from regulatory experience and attract foreign investment in the long run. It needs to retain the exchange-as-public-market approach and the market failure grounds of regulation in order to allow creation of limited number of exchanges and regulate the potential damages that may follow the profit motive. It needs to allow the creation of only one national exchange in the capital city in order to concentrate on market and regulatory capacity building as it starts; and allow the creation of competing regional exchanges in order to increase decentralization and achieve balanced economic development as regulatory

capacity and the securities and investment businesses grow. It also needs to organize the securities market with wings for primary and secondary trading, for government and private securities, and for debt and equity securities since these will need separate treatment as the international experience has shown.

2. It needs to make the company law more complete than it is now in order to set the rules for the varieties of securities of the share companies and enhance the corporate financing, governance, accounting and auditing regimes. It also needs to eliminate the rules in its current regime that discourage the issuance and trading of securities such as the restrictions on portfolio investments of the banks, insurers and microfinance institutions and the rule of the NBE that requires the trading of securities through subsidiary companies of the banks.

3. It needs to enact a securities market law that will do the following among others by way of learning from the international experience:

i. Make competition promotion, market development, investor and consumer protection, systemic risk reduction, and enhancement of market efficiency, integrity and transparency the main objectives of regulation;
ii. Mix between merit and disclosure regulation;
iii. Introduce and regulate the modalities of public issuance and trading of securities without ruling out the possibility of issuing securities through the methods other than the public issuance method;
iv. Require the securities market and its intermediaries to meet licensing requirements, including incorporation, initial capital, professional competence, behavioural integrity, ownership spreading, and governance quality;
v. Require:

- the securities market to be incorporated as demutualized share company whose shareholding will be open to any one who may or may not be securities market actor;
- the intermediaries to be incorporated as private or public limited companies with share capital, to be members of the recognized (incorporated) securities market, and to have staff that need to meet competence and integrity related requirements; and
- the individual securities market actors to be employees of the incorporated intermediaries;

vi. Control the danger of monopoly of the securities market by the financial and other companies and ensure its separate existence from the other financial markets such as by imposing ownership ceilings and/or diversification requirements;
vii. Require the securities market and the intermediaries to meet ongoing financial and non-financial requirements, including capital adequacy, reserving, accounting, auditing, reporting, public disclosure, and contribution to industry guarantee fund;

viii. Require separate registration of the public and private issues by the securities market regulator and others;
ix. Require registration and listing of the companies and securities that use the public issuance method by the regulator and the securities market; and restrain trading of the listed securities outside the recognized market;
x. Sanction insider trading, price manipulation and fraud; allow the follow up, suspension and cancellation of trading; and enable ongoing supervision of the listed companies and securities, the securities market, and the intermediaries by the securities market regulator;
xi. Require compulsory accounting and auditing of all the companies that use the securities market;
xii. Require disclosure of all material information to the regulator, the securities market and the public through publication of prospectus (during initial issuance) and reporting (during subsequent trading) by all issuers of securities that will use the public issuance method; and
xiii. Regulate the trading of securities issued outside the public issuance method on the securities market.

Automation of the securities market is, however, a matter of access to technology. The country needs to work on it. The experience with some of the newly created securities markets suggests that the country can start with automated trading if it cooperates with the advanced exchanges. The country also needs to upgrade the Addis Ababa Check Clearing Office at the NBE to make it provide centralized securities custodian, clearing and settlement services as it starts the securities market; and require the dematerialization and central custodian of securities and automation of the clearing and settlement services by a national company to be incorporated outside the securities market as the securities businesses and the communication infrastructure of the country grow. It also needs to consider the experience with the agricultural commodity market in these regards.

The adoption of self-regulation in the securities market of the country is also a matter of prudence, capacity and ethics of the future market actors as this has also been the case in the other countries. The country needs to start with a principle of government regulation and consider the case for self-regulation as these conditions mature.

It also needs to make its tax regime non-discriminatory and contributory to the development of the securities market. It needs to reconsider the current exorbitant capital gains tax on sale of shares and treat the equity market in the way the debt market and the existing financial services (and transactions) are treated. It also needs to treat the interest incomes from debt securities of the private companies in the way it treats the incomes from government bonds and treasury bills.

6.3 The Development, Policy and Regulation of Private Pensions

i. The International Experience

Pensions have originated as occupational benefits when the Bank of France sponsored them as early as 1808. They have begun to grow as state sponsored occupational schemes when Chancellor Bismarck promoted them in Germany in 1889. They have grown into contributory and non-contributory schemes for the employed until the First World War and into social security systems for the citizenry in the 1930s and thereafter through the help of international conventions sponsored by the ILO. Most of the developed countries have expanded the provision of social security through state sponsored occupational and welfare schemes in the period after the 1930s. The pension systems of these countries have ranged generally between the occupational pension (welfare capitalism) of the US and the state social security (welfare state) of the Scandinavian countries. Hence, most of them had unfunded, defined benefit, pay-as-you-go social security or occupational pensions until the mid 1990s. A number of the developing countries have also attempted at introducing pensions following adoption of the different international conventions although they have lacked adequate social security systems.

Most of the developed market countries have, however, privatised their pensions after the mid-1990s and introduced multi-pillar pensions due to demographic changes and efficiency concerns. They have seen the possibility of providing pensions through the market and adopted a public-private welfare nexus where they run a mixture of first pillar basic social security, second pillar private occupational pensions, and third pillar private life insurance annuities. Most of them have developed the second pillar pensions as defined contribution based individual accounts as opposed to the traditional pay-as-you-go system while some like Italy, Sweden and the Netherlands have followed a middle road between the pay-as-you-go and the individual account approaches by introducing a nominally defined contribution (NDC) pay-as-you-go system (Italy and Sweden) and a stand-alone-capital funded-collective pension system (the Netherlands). A number of them have also introduced reserve funds for the remaining pay-as-you go first pillar pensions. Most of them have also used the pensions to carry out functions within and outside the financial system. They have used them to provide for retirement income security, enhance saving, promote investment, facilitate corporate financing, and assist the development of the capital and labour markets. They have enhanced these roles of the pensions through the reforms of the post-mid 1990.

A number of the transition and emerging market countries have also encouraged the development of private pensions and life annuities after the mid-1990s because of the pressure of demographic change, diminishment of the extended family systems to care for the retired, and growth of domestic demand and international pressure for pension coverage. They have also encouraged the private pensions to play roles similar to the roles the pensions in the developed market countries have played (including the provision of retirement income and contribution to the development of their securities markets) by the reforms since their old public pensions did not offer sustainable retirement income security and achieve the other goals. Some like Chile have also stood as examples of successful pension privatization.

The developed and the transition and emerging market countries have also organized the private pensions as legally separate pools of assets without legal personality or as incorporated entities with legal personality and subjected them to regulations that are justified by reasons within and outside finance and the risks involved in pensions (including investment, agency, and systemic risks). The regulations have aimed at the objectives of:

- enhancing pension coverage, adequacy and sustainability;
- assuring pension prudence;
- promoting and maintaining competition;
- protecting the pension consumers from the dangers of information asymmetry, pension failure and abuse;
- protecting the state and society from the burden and side effects of pension (such as the burden of fund guarantee on the state and the moral hazard problem of protection on society); and
- achieving the social policy objectives of poverty reduction and redistributive equity.

They have addressed the assets, liabilities and organizations of the pensions and regulated their funding, portfolio composition, surplus ownership, insurance, vesting and portability through licensing, initial and ongoing capital, reserve, asset segregation, governance, investment, asset custodian, external audit, actuarial valuation, reporting, public disclosure and fund guarantee requirements. They have also used prior approval, off-site surveillance, on-site inspection, punitive and remedial measures, and proactive and reactive actions of the regulators for enforcement.

The regulations and approaches are not, however, standardized yet. The pensions in many of the countries also suffer from weaknesses in regulation, governance, transparency and investment. Hence, the countries are advised to further improve on the regulatory and governance frameworks for their pensions, smooth the fluctuations on pension asset returns, and reduce the exposure of the pensions to market and non-market risks.

The recent concern in most of the high income countries is also on the further development of sustainable and equity market based pension systems with appropriate regulatory and fiscal environment. The concern in the middle income countries is on expansion of system coverage, reduction of risk and uncertainty, sustenance of finance and investment, enhancement of efficiency and equity, enhancement of saving, diversification of the financial markets, enhancement of the market oriented reforms, enhancement of regulatory capacity, and reduction of poverty. The poor countries are also advised to consider the development of formal private pensions as one among the many reforms that should be implemented to reduce deprivation and vulnerability.

The enhancement of private funded pensions is also recommended in the aftermath of the 2008 financial and economic crisis in order to have balanced and secure pension systems. The World Bank also recommends adoption of a five pillar pension system by adding 'zero pillar' (which should be non-contributory and universal) and fifth pillar (which should include not direct monetary benefits but the provision of non-monetary benefits such as housing and health care for the retired poor) to the three pillars (i.e. the first pillar PAYGO system, the second pillar funded scheme, and the third pillar insurance related voluntary saving scheme).

ii. The Case of Ethiopia

Ethiopia does not have comprehensive social security. It has only occupational pension for government employees, some provident fund scheme for private sector employees, and some social assistance for the old, the destitute and the needy. The occupational pension for the government employees does not serve as universal basic system since it provides only subsistent income to very small population of the country. It does not also serve the functions of facilitating saving, employment, investment, corporate finance and capital market development since its benefit payments are small and its resources are hardly invested. The private sector provident funds and social assistances do not also serve these functions since they are informal and voluntary payments. The occupational benefits and severance pays in the private sector are also piecemeal and negligible. The provision (and consumption) of life insurance and pension annuity is also very negligible. The country needs to expand its pension coverage in order to curb these problems and reduce retirement poverty.

The country also needs to focus on two functions which are important for the development of the financial market: i) forcing saving and ii) mobilizing the saving for investment. The Ethiopian households and individuals are reported to have very limited saving due to both their expenditure habits and the low levels of their incomes. The direct mobilization of saved resources from the households and non-households to investment is also weak due to absence of formal institutional savers and the market mechanism for direct resource mobilization.

Hence, the development of private pensions is necessary along with the improvement of the governmental pension system, the encouragement of private insurance, the creation of securities market, and the taking of other developmental measures. The country needs to enable this by:

i) making the pension reform part of its poverty reduction strategy and the saving and investment promotion and financial market development policy;

ii) compelling the employers and employees in the formal private sector to participate in the private pension system as this has been done for the governmental pension; and
iii) enacting a retirement law for the private sector.

It also needs to consider the issues of organising the private pensions:

- as entities separate or unified with the existing governmental pension system and the financial institutions;
- as consolidated or set of independent funds;
- as incorporated or unincorporated institutions;
- as funded or unfunded institutions;
- as defined benefit or defined contribution schemes; and
- as competing or public good institutions.

It needs to separate them from the existing governmental pension system since the latter has not been efficient in the tasks of collecting contribution, generating income and paying benefits. It needs to separate them from the insurance and microfinance institutions since i) the insurers and microfinance institutions are not engaging in pension business despite their authorization to do so and ii) the merger of the pension, insurance and microfinance sectors will have the disadvantage of eliminating alternative channels and competition for saving, resource mobilization and investment. It needs to require institutionalisation of the pensions as incorporated share companies with their own governance since there is no management experience for unincorporated pension funds in the country and the share company form is the commonest and preferred structure for organization of the financial institutions in the country with the advantages of combining capital, reserve, limited liability, professional management, shareholder participation (in governance), accounting, external auditing (and control), and information disclosure. It needs to start with the demutualized profit making share company form and consider the mutual company form of incorporation when it becomes necessary since its current company law regime knows the demutualized profit making company form and there is no public movement for creation of non-profit making mutual companies. It needs to follow the funded defined contribution approach and adopt mechanisms (including minimum pay, industry fund guarantee and similar regulatory requirements) through which it will protect the individual pension members from the risk shifting effect of the approach since this is the international trend. It needs to organize the private pensions as competing institutions with the necessary regulation since the international experience (and the country's own experience with the current government pension system) also show that the protected monopoly approach leads to distortions and weaknesses instead of benefits.

It also needs to adopt a pension regulation that will do the following by way of learning from the international experience and addressing the domestic situation:

1 Make the immediate objectives of regulation to be i) expanding coverage, ii) reducing retirement poverty, iii) enhancing saving, and iv) making the pension contributory to the development of the financial market (including the future securities market) since the majority of the population are living without retirement pension and there is lack of long term saving to finance investment;

2. Make the long run objectives of regulation to be i) enhancing adequacy, sustainability, competitiveness and prudence of the pensions; ii) assuring protection of consumers; and iii) eliminating the information asymmetry and moral hazard problems that may follow the pension provision since the international experience also shows that these are also important when private pensions grow; and

3. Make the content of regulation to be related to the assets, liabilities and governance matters of the pensions in order to regulate the funding, portfolio composition, surplus ownership, insurance, vesting, and portability of the pensions by licensing, ongoing monitoring, and ex-post supervision rules that will:

- include qualification, legal form, initial and ongoing capital, reserve, minimum guarantee, insurance, asset segregation, investment, asset custodian, actuarial valuation, external audit, risk prevention, reporting, public disclosure, and related governance requirements; and

- be enforced through proactive and reactive measures of the regulator by way of learning from the international experience.

It also needs to restructure the governmental pension agency and subject it to the future pension regulation in order to enhance competition and performance.

It also needs to encourage creation of the private pensions through the tax regime by treating the private pension contributions, benefit payments and investment returns in the same way as the existing pension and provident fund contributions, benefits and returns are treated.

It also needs to promote the pension annuity businesses of the insurance companies through interventions in both the supply and the demand sides (including compulsion, tax incentives and raising awareness).

The country also needs to take the following two additional measures which will contribute to the aforementioned:

1. It needs to develop and transform the informal saving institutions of society (such as the *Edir* and *Equb*) and the saving and credit cooperatives in the labour market into formal mutual companies by enacting a law that will require this and giving them tax incentives. This will contribute to the functions of enhancing and mobilizing private savings since these institutions are closest to

households and individuals. It will also mean revolutionizing a sector which has lived for long as informal and unknown.

2. It needs to enact minimum wage law. This will cure the cases of low payment by the private sector employers and the government and thereby enhance the saving potentials of individuals for deployment to the private pensions.

These two measures need not, however, be considered as pre-conditions for creation of the private pensions. They are peripheral measures that can contribute to the enhancement and mobilization of saving and, hence, the creation and development of the private pensions.

6.4 The Design of Means of Enforcement of Regulation

i. The International Experience

Many of the countries have integrated their financial market regulators in and outside their central banks in the post 1990s period. The majority of them have made the integration outside their central banks. The countries that have not integrated their regulators have also looked for ways of coordinating between the separate regulators. They have followed either a lead regulator model where one of the traditional institutional regulators takes the responsibility to lead the group of regulators and becomes a de facto conglomerate regulator or a functional model where separate institutions regulate the competition, market conduct, asymmetric information and systemic stability functions across the banking, insurance, securities, pension and other markets. The Netherlands has employed a mixture of the integrated and functional models by integrating the prudential regulation of all the financial institutions in the Central Bank and putting the regulation of the quality of businesses (market conduct) of the financial institutions in the Authority for Financial Markets. The US has included elements of the functional regulator model in its most disintegrated regulatory structure.

The international experience has also shown that all the three (i.e. the integration, lead regulator and functional) models have advantages and disadvantages and that the integrated regulator model is favoured in the majority of the countries for the reason that it is easier to handle inter-departmental conflicts within a regulator than conflicts between separate regulators. It has also shown that:

- the choice of appropriate regulatory structure is a function of the financial market development and specific context in a country despite the general trend towards the integrated regulator model;
- the choice should not be between full integration and total fragmentation but from a spectrum of forms of integration;
- the transition from the fragmented to the integrated regulatory structure requires time and careful planning;
- the choice of particular regulatory structure should be based on the best way of achieving the objectives of regulation; and

- the new regulatory structure should be backed by change of legal framework, creation of strong governance structures, careful management of the working habits, skills and insecurities of staffs of the regulators, and enhancement of the communication mechanisms with stakeholders.

The integration outside the central bank is also favoured for the reason that the central bank will be overwhelmed by the regulatory functions if the integration is made in it. The ability of central banks to act as super regulators to prevent crisis in the financial market is also questioned in the aftermath of the 2008 financial and economic crisis.

Many of the countries also enforce their competition policies and laws through independent competition authorities and the courts. The issue in competition enforcement has been on whether to follow an administrative or a judicial approach. The continental countries have moved from a system where the administrative approach used to be dominant to a system that recognizes the importance of the judicial approach. The Anglo-American countries have relied more on the judicial than the administrative approach. The recent move in both groups of countries is towards increasing the use of the judicial enforcement machinery without diminishing the use of independent competition authorities.

Many of the countries also entrust their financial market regulators and competition authorities with differing degrees of rule making, monitoring, investigating, sanctioning and dispute settling powers. They authorize them to grant, deny and revoke licenses; make market entry, operational and exit rules; require reports for off-site surveillance; conduct on-site inspection and examinations; issue enforcement orders; takeover the management of the financial institutions; and enforce liquidation orders and other sanctions.

They have also increased the independence of their regulators and competition authorities from political and bureaucratic interference and made them more proactive than reactive as crises, anti-competitiveness and illegal actions recurred and market based systems grew. They have made them increasingly responsible for building their own capacities and the capacities of the financial markets and actors, advocating competition, fighting illicit financing, and contributing to general formulation of economic policy on top of their traditional functions.

They also subject the financial institutions and actors to different degrees of civil (tort), administrative and criminal sanctions. The use of the tort and criminal sanctions for regulatory and competition law enforcement has, however, also faced limitations and the countries have been looking for ways of solving this. The solutions have varied from country to country. The trend has been towards imposing strict liability with ways of balancing between the interests of ensuring compliance and legal protection. The advice has also been towards enhancing the criminal tracing mechanism, reducing the reluctance of enforcement organs, and increasing international cooperation.

The regulators and competition authorities in many of the countries are also subject to varieties of principles of administrative law and degrees of control through the legislature, the chief executive in government, the judiciary, some peripheral institutions and the public. Several of the countries also expressly provide for the judicial review of administrative (and regulatory) actions in their constitutions while others do it without express provisions in their constitutions. Most of the countries, however, also apply the rules of judicial review to the financial market regulators and competition authorities with modifications inspired by interest not to encroach upon the strictness and quasi-political character of financial market regulation and competition promotion. Most of the countries do not also allow individual consumer action to challenge the decisions of the regulators and competition authorities under reason that the latter are acting for public interest. They recognize and enforce the interest of consumers as group.

Many of the countries have also made the regulators and competition authorities work with national, regional and international institutions that have stake in the financial market and competition matters including the Bank for International Settlements (BIS), the IMF, the World Bank, the WTO, the UNCTAD, the OECD, the World Savings Banks Institute (WSBI), the International Accounting Standards Committee (IASC), the International Federation of Accountants (IFAC), the BIS Committee on Payment Settlement Systems (CPSS), the G-7 Financial Action Task Force on Money Laundering (FATF), the G-7 Financial Stability Forum (FSF), the International Corporate Governance Network (ICGN), the Global Corporate Governance Forum (GCGF), the Basle Committee on Banking Supervision (BCBS), the International Association of Insurance Supervisors (IAIS), the International Organization of Securities Commissions (IOSCO), the International Organization of Pension Supervisors (IOPS), the International Association of Deposit Insurers (IADI), the International Competition Network (ICN); the G-20, and several other regional institutions, organizations and committees. They have also used the recommendations and standards of these organisations as minimum benchmarks for their regulatory and competition law instruments and enforcements. They have also seen the importance of increasing regional and international cooperation in the fight against illicit financing, containing financial market crisis, and building regulatory and competition law enforcement capacity before and after the 2008 financial and economic crisis.

ii. The Case of Ethiopia

Ethiopia makes the NBE regulator of all the financial institutions, markets and auxiliaries and enforces the existing regulations through banking, insurance and microfinance supervision departments organized in it. It confers it with the powers of licensing, inspecting, examining and sanctioning the financial institutions, markets and auxiliaries. It also confers it with some discretion and autonomy from the government. It also authorizes it to finance its regulatory functions by its own funds except in cases where it has been fixed by law that the funding has to be borne by the regulated institutions. It enforces the competition policy and law through a Secretariat established in the Ministry of Trade and Industry, a Federal Trade Practice Commission established under the Ministry, and regional legislative councils and trade bureaus. It also recognizes the enforcement of civil, administrative and criminal sanctions against regulatory violations. It also generally subjects the actions of the NBE and the competition enforcement organs to judicial review under the unique system and allows the financial institutions against which the NBE passes decision of receivership or takeover of management, reconstruction, winding up or dissolution to petition to the Federal High Court. It also recognizes substantive and procedural principles of good administration in its constitution and other laws. It has also established Ombudsman Office that checks the operation of governmental authorities as peripheral administrative control mechanism. It also works with the IMF and the World Bank. The banking and insurance supervision departments of the NBE also sometimes attempt at assessing their regulatory and supervisory practices against the core principles of the Basle Committee on Banking Supervision (BCBS) and the International Association of Insurance Supervisors (IAIS).

The country does not, however, confer the NBE with regulatory dispute-adjudication powers. It does not also prescribe the measures the NBE may have to take during crisis situation that may transcend an individual financial institution to affect the financial sector or the economy as a whole. It also makes the regulatory independence of the NBE fragile by authorizing the Prime Minister and the Council of Ministers to administer it directly. It also puts the competition enforcement organs under direct control of the Ministry of Trade and Industry and makes the Trade Practice Commission not anything more than dispute investigation office. It does not also clearly define the work relationship between the NBE as the financial market regulator and the competition enforcement organs. The NBE does not also fully enforce the tools of off-site surveillance and on-site examination. It does not also enforce its penalties and corrective measures strictly although it, in practice, issues directives that subject the financial institutions to financial and non-financial penalties. The country also lacks administrative procedure law and the actions of the NBE and the competition enforcement organs are not judicially reviewed against their legal and public interest grounds in practice. It does not also define the exact roles of the Ombudsman Office vis-à-vis the NBE and the competition enforcement organs. It does not also oblige the NBE and the competition enforcement organs to conduct public consultation during the making of their decisions, rules and actions. The principles of good administration recognized by the country are also scattered in the different laws making enforcement difficult. The supervision departments of the NBE and the competition enforcement organs also suffer from staff and fund constraint. Both are not also members to regional and the international organizations working in the area of financial market regulation. The regulatory enforcement regime of the country also complies little with the core principles of the BCBS and IAIS. The country needs to improve on all these in order to enhance both regulatory and competition enforcement and legal protection. The following need to be done among others:

1. The existing regulatory enforcement machinery needs to be enhanced by:

- entrusting the NBE with dispute adjudicating powers regarding regulatory matters between the regulated institutions without, of course, ruling out the possibility of making recourse to the judiciary;
- indicating the measures the NBE should take during crisis situation;
- refining the grounds for receivership of the banks and microfinance institutions;
- requiring and empowering the NBE to:

    - design and enforce its regulation proactively,
    - promote diversification of the financial market,
    - raise regulatory awareness,
    - build its own capacity and the capacities of the financial institutions,
    - advocate the importance of competition in the financial market (in cooperation with the competition organs), and
    - avoid reluctance in the enforcement of regulation;

- defining and strengthening the powers, functions and roles of the NBE in the fight against illicit financing;
- increasing the leadership, operational and financial autonomy of the NBE from the executive in government (as the financial market regulator);
- enhancing the funding, staff capacity, and financial and operational independence of the supervision departments of the NBE; and
- defining the grounds and mechanisms for accountability of the NBE (as the financial market regulator) to the legislature and the chief executive of government; and
- enabling and requiring the NBE to work with national and international networks of cooperation including the BCBS and IAIS in order to enhance the tasks of building capacity, refining regulation, preventing systemic crisis, and controlling illicit financing.

2. The competition enforcement machinery needs to be enhanced by:

- re-establishing the general competition law enforcement organs as independent competition authorities with the complete powers of rule making, inspecting, examining, intervening, adjudicating and sanctioning; and defining their accountabilities to the legislature and the chief executive of government;
- enhancing the proactive and competition advocacy roles of these organs; and authorizing their participation in the formulation of economic policies by the government in order to check the consistency between the competition and other policies;
- making the financial market regulator responsible for enforcement of the competition objective in the financial market (along with the general competition law enforcement organs);

- defining the work relationship and coordination between the financial market regulator and the general competition law enforcement organs; and
- enabling and requiring the competition law enforcement organs to work with national and international networks of cooperation including the ICN in order to enhance the tasks of building capacity, refining the competition law, increasing advocacy, and strengthening the competition law enforcement.

3. The regulatory sanction and legal protection mechanisms need to be improved by:

- giving attention to the problems criminal and tort sanctions face in connection with regulatory and competition law enforcement and balancing between the need for ensuring compliance and legal protection;
- limiting the use of criminal law and its guilt requirement to the most serious contraventions;
- making the imprisonment of corporate managers, fine and forced closure of business the main forms of criminal sanction for the most serious contraventions (since corporate probation is not feasible in the current legal situation of the country);
- making all the regulatory and competition law contraventions civil fault that will result in strict civil (tort) liability without need to prove mental situation;
- subjecting the majority of the regulatory and competition law contraventions to strict administrative (regulatory) sanction;
- requiring the financial market regulator and the competition enforcement organs to exercise their powers according to defined substantive and procedural principles of good administration;
- requiring the financial market regulator and competition enforcement organs to include public consultation in their regulatory and competition enforcement processes;
- subjecting the rules, decisions and actions of the financial market regulator and the competition enforcement organs to judicial review expressly; and

    - indicating the applicants and the judicial organs that will have the power to make review;
    - including the regulated financial institutions and actors, a defined number of the consumers as a group, and other interested parties including the government in the list of applicants for judicial review;
    - collecting and standardizing the substantive and procedural grounds of review;
    - defining the procedure and remedies of review;
    - demarcating the line of jurisdiction between the reviewer and the financial market regulator and competition enforcement organs; and
    - adopting a comprehensive administrative procedure law for the judicial review;

- allowing individual suits for extra-contractual compensation against the regulators and competition enforcement organs when the regulators and

competition enforcement organs violate the bounds of their legal authorizations and cause damage on individuals;
- defining the roles of the Ombudsman Office against the financial market regulator and the competition enforcement organs; and
- building the mechanism for tracing violators of regulation.

The country also needs to empower and encourage the NBE, the competition enforcement organs, the business community and the other stakeholders to contribute to the development and diversification of the financial system (including development of the future securities market and private pensions). It also needs to do the following in respect of the future securities market and private pensions:

1. It needs to create the securities market and pension regulators with financial and operational autonomy from the executive in government and the following powers and functions:

    - making rules and adjudicating cases;
    - inspecting, investigating and sanctioning abuse and violations;
    - evaluating, preventing and correcting institutional failures;
    - enforcing disclosure requirements;
    - encouraging the making of ratings;
    - keeping and publishing data about the market institutions and operations;
    - conducting research;
    - building their own capacities and the capacities of the market actors; and
    - advising the government on policy matters.

2. It needs to define and scale the measures the securities market and pension regulators will take against the securities market and pension operators during regulatory violation and crisis situation and leave discretion to the regulators on the choice of particular measure as in the case of the banking, insurance and microfinance markets.

3. It needs to make the securities market and pension regulators work with the international organizations working in the respective fields including the IOSCO and IOPS in order to facilitate the enhancement of their regulatory functions and align the regulatory enforcement regimes with the principles and standards of the international organizations.

It also needs to consider the case for integrating the financial market regulators outside the NBE when the securities market and pension regulators are created so that the existing and future regulatory functions will be coordinated and the NBE will not be suffocated by integrating the regulatory functions in it.

6.5 General Lesson

The discussions and conclusions made in this study towards development of the policy and regulation of the banking, insurance and microfinance markets and institutions and creation of securities market and private pensions in Ethiopia and the data and international experiences which substantiate them also show the following. Ethiopia needs to take these into account as well in pursuing its financial market regulatory reform.

1. The development and regulation of a country's financial system is a matter of policy determination and coordination between its market and government institutions. It is important that a country possesses clear vision about the targets of its reforms; clearly defines, prioritizes and links between the objectives and instruments of its regulation; makes its reforms holistic as opposed to piecemeal; sequences its reforms clearly by taking into account both domestic and international context; and possesses strong determination in the pursuit and implementation of its reforms.

2. The presence of diversified financial markets, institutions, instruments and services (in particular, the presence of a financial market that allows the interaction of both debt and equity finances and encourages the development of institutional savers like pensions) is important for a country although small its economy is.

3. A country whose foreign capital inflow is at very low level needs to see the diversification of its financial markets, institutions, instruments and services and the creation of securities market and private pensions primarily as means to enhance domestic saving and mobilize domestic resource for long term finance and related functions and secondarily as means to facilitate foreign investment.

4. A country need not expect to have its regulatory capacity fully grown in respect of a particular market before making the market itself operational since regulatory and market capacities are matters that influence each other and grow together through time. It needs to put in place both proactive and reactive measures (that can encourage development and reduce risk) in the regulation of its financial markets, institutions and services; and refine the regulatory regime through time according to developments in the markets. Working with the regional and international organizations which specialize in the fields of financial market regulation is also important to enhance the development of regulatory capacity and enforcement.

5. A country also needs to enhance the development, diversification and regulation of its financial markets, institutions and services by making its tax regime non-discriminatory and contributory to development.