

Final Report

Technical Assistance to the Botswana Stock Exchange

CARANA Corporation

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Trade Enhancement for the Services Sector (TESS) Project





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I. BACKGROUND

The economic environment in Botswana is one of the most favorable in Africa as indicated by the country's long track record of rapid and sustained growth, sound economic management, strong and democratic institutions, as well as political and social stability. Overall, real GDP growth is estimated to have averaged around 9% of GDP with per capital income growth rates of 7% making Botswana the richest non-oil producing country in Africa.¹ Towards this end, the financial sector of Botswana continues to grow at pace with inflation and real economic growth. However, despite these strong gains there has been minimal progress in the development of the capital markets sector. While the financial system can boast an independent central bank, five commercial banks, four insurance companies, one mortgage company, one hundred and fifty nine pension and provident funds and several asset management companies—overall capital market development has not kept pace with this rapid development (and diversification) in the financial sector. As a result, the Government of Botswana is deprived of a broader fiscal base, which in turn forces an over-reliance upon the mining sector to finance a broad array of infrastructure and social needs.

Since the launch of the Financial Sector Development Strategy in 1989, there can be little doubt that there has been a significant increase in the number of banks and financial institutions. Yet, private enterprises continue to have limited access to capital because commercial banks are risk-averse in their lending patterns (partly to comply with prudential regulations), or are simply content to invest in Bank of Botswana Certificates (BOBC's), which pay inflated yields. Simultaneously, non-bank financial intermediaries (NBFIs), such as leasing companies, mortgage banks, insurance companies and private pension funds, have not provided the needed capital resources to promote private sector development. Furthermore, due to this underdevelopment in the capital markets sector, the Botswana Development Corporation (BDC), a government-sponsored venture capital fund, is left with no viable exit mechanism for their equity investments. Current practice demonstrates the majority of these investments are settled by forcing the enterprise to repay the debt or buy back the equity ownership position adopted by the venture capital fund. This practice undermines the principle purpose of venture capital financing and, in most cases, places the private enterprise further in debt.

Lastly, the Government of Botswana has indicated that the scheduled privatization of Air Botswana will include a segment earmarked for the exchange (15-20% of the privatization). Discussions with Government of Botswana officials and employees of the BSE have revealed that the Air Botswana privatization will set the benchmark by which a broader privatization effort will be undertaken by the Government. Although the IFC has provided an advisor to Air Botswana to assist in this privatization, the stakes for "getting it right" are going to be quite high.

In sum, although there have been significant strides made in the past several years towards development of the financial sector of Botswana, there is an overwhelming need for technical assistance focused directly at the capital market. In order for Botswana to have a viable capital market that attracts foreign direct investment, mobilizes domestic savings and provides a cost-effective and transparent mechanism for capital allocation, it must have a system that deserves and obtains the trust and confidence of

¹ See: UNDP Economic Commission for Africa: "Reports and Recommendations on the Needs and Organizational Structure of the Botswana Stock Exchange." January 2003

investors. This report identifies those focus areas, which will assist the Government of Botswana in achieving that goal.

A. THE BOTSWANA STOCK EXCHANGE

The Botswana Stock Exchange was established in 1989 as the Botswana Share Market, and became the Botswana Stock Exchange in 1995 under the legislation of the Botswana Stock Exchange Act. The licensing and regulatory authority is the Ministry of Finance. The Exchange has a listing of sixteen domestic and seven foreign companies. In addition, there are four corporate bonds, one venture capital company and one instrument of commercial paper. This amounts to a total of twenty listed securities. All listings are included in the Botswana Share Market Index (BSMI), which is weighted according to the volume of shares in issue and the current bid price. There is a distinction between domestic and foreign companies index. Private investors are estimated to account for fewer than 10% of the total market capitalization. The framework under which trading is conducted is as follows:

- ◆ Trading is conducted from Monday to Friday 9:00 hrs to 16:00 hrs;
- ◆ Trading occurs by the open out-cry system while clearing occurs transaction by transaction;
- ◆ Dealing costs are a percentage of the total consideration on the scale: P0 – P50,000 = 2%, P50,001 – P100,000 = 1.5%, P100,001 and over = 1%; (P=Pula, the currency of Botswana, approximately Pula 1.00=\$.21)
- ◆ Stock Exchange handling fees: P15 per bought note and P10 per sold note;
- ◆ A 15 percent withholding tax on dividends is levied;
- ◆ There is no capital gains tax;
- ◆ Settlement is due five days after the transaction is completed (T+5) for both local and overseas clients;
- ◆ Foreign investment and foreign ownership regulations stipulate that no one foreigner may own more than 10% of the issued share capital of a publicly quoted company, and foreign ownership of the free stock of a local company trading on the Exchange may not exceed 55%; and
- ◆ Repatriation of funds is allowed up to P100m immediately. Amounts exceeding P100m may be required to be repatriated over a specific period.

The origins of the Botswana Stock Exchange can be found in the Botswana Development Corporation's (BDC) need for a vehicle to sell its investments in 1989. Between 1989 and 1995, the listing rules, member rules and all general rules were adopted with assistance from the Zimbabwe Stock Exchange. In June 1989, the BDC together with Barclays Bank, Standard Bank and a Zimbabwe stockbroker, Edwards & Co. (Pvt) Ltd., established an informal share market under the auspices of Stockbrokers Botswana Ltd. The Botswana Share Index was set at 100 at the commencement of operations in June 1989. There were only five listed companies quoted on the maiden Botswana Share Market (BSM). The Index continued to grow and P80 million was raised on the market by 1993. By 1998, further listings and an increase in the volume of shares transacted made it opportune for another broker to enter the market bringing the number of registered stock broking companies to two. The capital markets continued to flourish, and by February 2000 a third stock broking company was licensed.

During 1997, the Botswana Stock Exchange saw increased investor interest arising from positive economic developments, such as the 1997 national budget, cheap share prices and forecasts of average corporate earnings growth of 20%. With a \$US capital return of over 90%, it was one of the best performing stock exchange in the world that year. Although the returns were not quite as spectacular as the previous year, 1998 was also a good year for the Exchange as it achieved \$US capital returns of just under 15%. As of June 2001, 16 companies were primarily listed on the BSE and are included in the Domestic Companies Index. Seven additional companies were listed on the BSE as dual listings, and were included in the Foreign Companies Index.

B. THE SECRETARY OF THE EXCHANGE

The two key functions of the Exchange (i.e. administration and secretarial work) were outsourced to Ernst & Young until March of 2003. The administration functions outsourced included provision of offices, infrastructure, and telephones as well as other operations of the Exchange. The role of the Secretary of the Exchange was also outsourced to the same firm. The duties delegated included dispute resolution, compliance, disciplinary actions as well as other self-regulatory responsibilities. The Listings Committee also delegated its work of vetting applications for listing to Ernst & Young. This function is generally performed by the Secretary, who is responsible for administering the rules and regulations of the Exchange.

In March of 2003 it was understood that there was an inherent conflict of interest in having E&Y perform the administration functions of the Exchange, and the two were separated. Since then, the BSE has begun to expand its staff to develop its institutional capacity as well as expand its functions as an SRO. However, it is important to stress that the BSE is in its nascent stages of development as an SRO and will need a great deal of assistance to make the full transition to a world class SRO recognized by FIBV and the World Federation of Stock Exchanges.

C. THE REGULATORY FRAMEWORK

The Botswana Stock Exchange Act

As stated earlier, an informal stock market was established in 1989 managed and operated by Stockbrokers Botswana Ltd. During the first few years after its establishment, it performed remarkably well in terms of the level of capitalization, the value of shares and the returns to the shares. It was not until 1995 that a formal stock exchange was established under the Botswana Stock Exchange Act. The Exchange contributed to the promotion of Botswana as a destination for international investment.

Between 1989 and 1995, the listing rules, member rules and all general requirements were applied with assistance from the Zimbabwe Stock Exchange in the share market. Botswana did not have an applicable statute or act such that the Exchange had no legal status. An interim Stock Exchange Committee comprised of two stock broking members and three members appointed by the Ministry of Finance was established. The Exchange became a legal entity on 1st November 1995 after parliament passed the Botswana Stock Exchange Act in August of 1994. With the establishment of the act, the necessary regulations and rules were enforced for the operations of an efficient securities market with a legal status.

The Botswana Stock Exchange Committee

The committee that oversees the Exchange consists of three ministerial appointees and a further six members may be elected by the committee, with no more than two people being elected from any one stock broking firm. Presently, there are seven committee members. Subject to the provisions of the Botswana Stock Exchange Act, the committee has the sole power to:

- Grant, review and suspend or terminate a listing of securities subject to the listing requirements;
- Prescribe the minimum listing requirements;
- Prescribe the minimum requirements with which a listed company should comply while a security issued by it remains listed;
- Suspend, alter or rescind listing requirements prescribed before or after a listing has been granted;
- Prescribe additional listing requirements by way of amendment of the listing requirements; and
- Prescribe the circumstances under which a listing of a security shall be or may be suspended or terminated.

The committee meets on a regular basis and has a number of subcommittees which meet when the need arises, for example, the Listing Committee will meet when a listing is being considered and the investigations Committee will meet to deal with any issues that are of concern to members of the investing public. Issues may include insider trading, disciplinary matters for brokers, and non-compliance by listed companies with the listing requirements. The committee members are not full time employees of the BSE.

II. CURRENT SCOPE OF WORK

The BSE currently has three major areas of immediate need in terms of restructuring its form and environment. The urgency of attending to these areas is occasioned by the need to ensure that the BSE is ready to be an adequate host for the listing of the Government of Botswana Bond. In its current form, the Exchange will not be able as a listing host to ensure that this bond's listing achieves its intended objectives, inter alia a vibrant secondary market. For instance, such vibrant trading will only be realized if investors have confidence in the legal, structural and operational framework under which the BSE thrives.

1. Establishment of a stand-alone Secretariat

This involves detaching the BSE from the operational curatorship of Ernst & Young. There is a lack of 100% dedication to the development of an activity of the Exchange because the mainline function of E&Y is provision of auditing and accounting services. Also, there is a conflict of interest in the performance of the duties of the BSE by E&Y especially where there is sometimes need to investigate the market behavior of a participant (broker, listed company, institutional investor) that is also an audit or accounting services client of E&Y. Therefore, for the BSE to execute and carry out its objectives, it needs to operate using a secretariat that is 100% focused on the operations and development of the exchange.

Taking the aforementioned into consideration, the BSE requested from USAID provision of assistance in the following areas:

- Assist the CEO in the strategic planning process of the BSE, and in driving the organization in the direction of achieving its strategic objectives
- Assist the CEO in drawing up a 5-year financially self-sustaining business plan for the BSE
- Assist the CEO in drawing up a phased organizational structure, with job descriptions, for the BSE

- Assist the CEO in drafting operational manuals for the BSE, e.g. trading, settlement, office accounting and internal control manuals

2. Redrafting the regulatory environment of the BSE

The current regulatory environment within which the BSE operates, i.e., the Botswana Stock Exchange Act, 1994, is clearly outdated and lagging well behind even that of its smaller regional competitors. It is important to have a good and up-to-date legal environment to harness investor confidence with respect to the integrity of the trading and settlement process of the market.

- Re-drafting of the BSE Act to bring it in line with regional and international standards
- Draft a Centralized Securities Depository Act
- Draft new rules and listing requirements consistent with the two new acts above

3. CSD Implementation Project

The USAID office in Washington has donated an electronic registry and clearing depository, clearance and settlement software package to the BSE. It is necessary to review/analyze the software package and determine its suitability for the BSE. To achieve this, the BSE requires a dedicated consultant to lead the implementation of this central depository software.

- Draw a self-sustaining CSD business plan; i.e. costs and revenue centers for the CSD. E.g. fees payable by the participants and fees for the CSD account holders. The plan will move in the direction of outsourcing the CSD management and operation to the BSE so as to rationalize the cost structure of the two companies.
- Customize and install the new USAID CSD software in accordance with the acts and regulations referred to above. Also, accommodate both the government and private sector listed instruments and anticipated listings.
- Train the staff on the operation of the software and the attendant equipment.

4. Assistance in Trading Government Bonds at the BSE

- Provide technical assistance to the Botswana Stock Exchange (BSE) with regard to the listing of Government Bonds on the BSE. This will include providing assistance to the BSE in adopting or revising its rules and operating procedures related to trading, membership, disciplinary procedures and other conduct by members to accommodate trading in government securities.
- Provide technical assistance to the BSE with regard to adopting or revising rules and operating procedures relating to clearance, settlement and depository activities for government bond trading (to date, trades in government bonds are settled ex-exchange).
- Assist the BSE in developing a central registrar to record transfer of ownership and trades in government bonds at the BSE.

- Provide guidance to the BSE and Ministry of Finance to ensure the legal framework (i.e. the Botswana Stock Exchange Act and rules) allowing for the listing and trading of Botswana government bonds on the BSE. In particular, review those provisions in the current Act or rules relating to:
 - Membership
 - Stockbrokers and their activities
 - Trading in scriptless or immobilized shares or units
 - Listing requirements and listed security
 - Settlements
- Draft proposed legislation/regulations to allow for the trading of G-Bonds on the BSE...including those for the registrar, the BSE as an Exchange, and for the membership. These will be “quick fixes” according to current legislation and rules.
- Attend various meetings for discussions of above; re-draft and refine legislation, regulations, rules and procedures.

III. PROGRESS AGAINST ASSIGNED AREAS UNDER THE SCOPE OF WORK

During the work with the BSE, significant progress was made in all areas assigned under the Scope of Work. In addition, as detailed below, the required next steps have been outlined to the BSE staff and there is a plan for capitalizing on the initial progress made.

Further, because our office was located within the Ministry of Finance and Botswana Stock Exchange, respectively, the staff was able to engage the CARANA Team on a daily basis with a variety of questions relating to matters outside the scope of work. These informal consultations provided an excellent setting to resolve what appeared to be recurring questions and issues. These exchanges of experiences and practices also provided the type of knowledge transfer sought under the short-term TA.

1. *Assist the CEO in the strategic planning process of the BSE, and in driving the organization in the direction of achieving its strategic objectives.*

During our time in Botswana, the CARANA Team worked with Tebogo Matome, the CEO of the Botswana Stock Exchange to develop the strategic plan for the BSE. At this time, it is important to note that prior to our arrival in Gaborone, the BSE had been provided with an advisor from the UNDP Economic Commission for Africa. This advisor had reviewed the existing environment under which the BSE was operating and produced a report entitled “Report and Recommendations on the Needs and Organizational Structure of the Botswana Stock Exchange.” While a comprehensive and detailed report, it did lack some fundamental recommendations relative to strategic planning and thereby was in need of refinement.

We began the strategic planning process by calling upon the staff members of the BSE to meet and outline their thoughts on what the vision and mission statements of the BSE should be. After that, we held several strategic planning meetings where we conducted a S.W.O.T (Strengths, Weaknesses, Opportunities, Threats) analysis of the BSE with a view towards developing an overall framework for each department of the BSE and laying out their strategic goals.

Finally, the BSE staff was asked to comment on a draft strategic plan that I prepared, and finalize their thoughts on the BSE's overall direction. From this final document, the BSE will seek approval from the BSE committee, which will then approve the strategic plan for implementation. After which, we have advised the BSE that they will then need to develop "Annual Operating Plans" which will lay the roadmap for how to achieve those objectives laid out in the strategic planning document.

2. Assist the CEO in drawing up a 5-year financially self-sustaining business plan for the BSE.

As stated above, the BSE was provided with a consultant from the UNDP who outlined in their report "Report and Recommendations on the Needs and Organizational Structure of the Botswana Stock Exchange." As part of this report, the UNDP advisor laid out a financial self-sustaining business plan that called for the subsidizing of the BSE by the Government of Botswana either through a direct grant facility or by paying an inflated listing fee for the government bonds, which were to be traded over the BSE in the near term. While we were in Botswana, the Government of Botswana committed to pay the inflated listing fee to provide some level of financial support to the BSE during its transition to an independent market operator.

Separately, we worked with the BSE during their strategic planning process to identify other areas of potential revenue which might also assist the BSE in achieving self-sustaining operations sooner rather than later. Some of these potential revenue opportunities included: (i) sale of market information to data vendors (i.e., Reuters, Bloomberg, Dow Jones, etc.) after which the listing of the government bonds will be a key source of revenue; (ii) utilization of the USAID-provided software for development of a clearance and settlement facility at the BSE which could generate additional transaction and corporate action fees; (iii) minimizing current cost centers; (iv) expanding the membership of the BSE to allow for direct and non-direct participants to access the BSE; (v) expanding the products and services currently being offered by the BSE (i.e., ETF's, Issuer Services, etc.); and (vi) offering a training facility for market participants and the investing public (and possibly press corps) which could license, certify and train participants in capital markets for a fee. Each one of these recommendations has been taken under advisement by the BSE

3. Assist the CEO in drawing up a phased organizational structure, with job descriptions, for the BSE.

As stated above, the UNDP produced report "Report and Recommendations on the Needs and Organizational Structure of the Botswana Stock Exchange" included a great many details with regard to the development of the BSE as an independent market operator. Inclusive in these recommendations was the outlined phased organizational structure, with job descriptions for the BSE. As this report had been accepted for implementation by the BSE committee, we were unable to make any concrete changes to the report recommendations. However, as agreed to by senior management and the CARANA advisors that the staff of the BSE would need to share responsibilities from time to time as the BSE sought to enforce its role as a self-regulatory organization.

For instance, the Corporate Affairs Manager is charged with the sole responsibility of surveillance and enforcement of the BSE's rules and regulations with regard to trading, listing and membership. However, the individuals charged with listing and trading management is in a better position to detect aberrations in trading patterns or volumes of a certain stock, in addition to malfeasance with regard to members conduct in handling of customer trades. It was suggested that the Listings and Trading Manager work closely with the Manager of Corporate Affairs to share this regulatory responsibility and ensure that an effective cross-training plan be put in place in order to expand the surveillance capability of the BSE. Simultaneously, the business operations function (accounting, cost management) could also assist with the review of financial reporting obligations both of members and of issuers. It was the suggestion of the CARANA

team that these responsibilities be shared in an effort to lighten the burden on the Corporate Affairs Department until such time that the BSE was large enough and generating enough revenue to acquire additional staff.

4. *Assist the CEO in drafting operational manuals for the BSE, e.g. trading, settlement, office accounting and internal control manuals.*

During the course of our activities in Botswana, the Deputy Minister of Finance, Trade and Development requested our assistance in the listing of Botswana government bonds at the Botswana Stock Exchange. Due to the amount of work required to bring this mandate to fruition, it was agreed that this particular component of the Scope of Work would be delayed until Phase II.

5. *Assistance in trading government bonds at the BSE.*

While working in Botswana, the CARANA Team was asked to amend their scope of work to include the provision of assistance to the MOF and BSE in developing a government bond market at the BSE. The MOF had deemed this to be a policy objective, in line with National Development Plan No. 9 and was keen to see the initiation of trading in these government bonds at the BSE by the early fall. The CARANA Team worked with our counterparts at the BSE and MOF to develop the following:

- a. Revising the rules and operating procedures of the BSE relating to trading, membership, disciplinary procedures and other conduct by members to accommodate trading in government securities.
- b. Provide technical assistance to the BSE with regard to adopting or revising rules and operating procedures relating to clearance, settlement and depository activities for government bond trading (these can be found in the attached document, “Operational Development Plan for Government Bond trading at the BSE”).
- c. Assist the BSE in developing a central registrar to record transfer of ownership and trades in government bonds at the BSE.
- d. Provide guidance to the BSE and Ministry of Finance to ensure the legal framework (i.e. the Botswana Stock Exchange Act and rules) allowing for the listing and trading of Botswana Government Bonds on the BSE. In particular, review those provisions in the current Act or rules relating to:
 - i. Membership
 - ii. Stockbrokers and their activities
 - iii. Trading in scriptless or immobilized shares or units
 - iv. Listing requirements and listed security
 - v. Settlements
- e. Draft proposed legislation/regulations to allow for the trading of G-Bonds on the BSE...including those for the Registrar, the BSE as an Exchange, and for the membership

- f. Attend various meetings for discussions of above; re-draft and refine legislation, regulations, rules and procedures
6. *Drafted the “Securities Act of Botswana, 2003” (or “Act”) (see attached deliverables), based on international best practices, IOSCO Principles, and my experience working in 9 emerging or developing markets.*

This Act is all encompassing, rather than limited in its scope as the current “Botswana Stock Exchange Act, 1994”. This draft “Act” includes sections on:

- a. The registration of public securities,
- b. Reporting and disclosure (i.e., corporate governance) requirements,
- c. Issuer registration,
- d. Public offers of securities,
- e. Regulations on the registration, licensing, and operations of securities markets, self-regulatory organizations, brokerage firms, brokers, and depositories/registries,
- f. Conduct of the securities business (e.g., ethics),
- g. Protection of shareholders,
- h. Prohibition of fraud, manipulation, and insider trading, and
- i. Liabilities and sanctions (for preventing or deterring abuse).

The re-drafting of this Act was accomplished after several meetings with the executive staff of the BSE, and a single meeting with Mr. Modise at the Ministry of Finance. Unfortunately, Mr. Modise did not completely read the draft Act, and had only read 20% as of the first week in September. Due to Mr. Modise’s lack of time and support personnel at the Ministry, he is having the BSE executive staff be responsible for the initial review of the draft Act.

The memo attached to and introducing the draft Act contains drafting notes and editing comments, to explain why items were included (or not included) in the draft and in the revision. Recommendations are made on this introduction memo as well, as to the needs for completing a final draft of the Act. However, due to the overall time constraint, the draft was not completely discussed.

7. *Drafted “Regulation on Government Securities Listing and Trading” (see attached deliverables).*

This regulation is ready to be presented for the signature of the Minister, and for publication in the Official Gazette of Botswana to become immediately effective. Within the first week of our work efforts in Botswana, it was apparent that the Government along with the Ministry, had the priority to list and trade (the newly issued) government bonds on the Botswana Stock Exchange (“BSE”), to support the Exchange monetarily (with listing fees) as well as to provide greater disclosure and transparency to the government bond market. This portion of the work was an ‘add-on’ by USAID, based on the needs of the Government of Botswana. This area of work became predominant and a priority based on the counterparts’ wishes and needs, and officially became an extension to the original SOW.

What was needed was a legal basis and framework for the trading of government bonds on the BSE by primary dealers (i.e., non-BSE member commercial banks). The current legislation did not allow banks to become members of the BSE, and likewise, the BSE’s own rules prohibited banks as becoming members. The law and rules stated that firms with the business only of stockbroking could become members, with some other minor qualifications. Therefore, the quickest route was to have the Ministry implement a

regulation, allowing banks or primary dealers, to become “special members” of the BSE. After drafting, discussions, meetings, and re-draftings, the regulation was presented to the Attorney General’s office for formal drafting. These regulations now approve the Banks becoming “special members” with restrictive rights and specific obligations on the BSE. These regulations also allow for the listing and trading of government bonds on the BSE, along with the BSE holding and operating the registry of ownership of the bonds.

8. *The “Botswana Regulation for the Central Securities Depository and Registry” was drafted (see document no. 4, attached).*

This regulation provides more detail and procedures necessary for the operations of the Central Securities Depository and Registry than what is described in the draft legislation. Again, this regulation was based on international best practices, IOSCO principles, and experience in working with this depository and registry system (the “Romanian system” for depository and registry, installed initially in Romania by USAID, and later installed in many other countries). The regulation follows the needs of the operator as well as incorporates the utilization capabilities of the depository and registry system itself.

Sections of this regulation include:

- a. General operational requirements and procedures of the Central Securities Depository and Registry (CSD),
- b. Safeguards in operating the system,
- c. Information and procedures needed for recording ownership and transfer of ownership or holdings,
- d. Pledging of securities,
- e. Handling of cross-border securities,
- f. Extracts from CSD as proof of ownership or holdings (note that it is recommended that the securities market will be certificateless, i.e. dematerialized or immobilized, as an IOSCO principle),
- g. Procedures for handling administrative actions for general meetings of shareholders, and
- h. Process for incorporating deterrent penalties as well as dispute resolution.

Due to time constraints, this draft regulation was delivered to Mr. Modise at the Ministry and to the executive staff at the BSE, but was not discussed.

IV. OTHER ACTIVITIES

Following is an illustrative example of other activities undertaken by the CARANA Team while on assignment in Botswana. These are items not covered under the scope of work but were necessary to complete in our daily interaction with our counterparts at the BSE and MOF respectively.

1. BSE Web site Development. The CARANA Team was asked to provide input as to the form and content of the BSE’s proposed Web site. The CARANA Team reviewed material provided by the BSE staff, which was to be published on the Web site and provided comments. Separately, the CARANA Team participated in BSE review and planning sessions with regard to Web site development and the selection of an Internet service provider and Web-hosting service.

2. BSE Insurance Policy Application. The CARANA Team assisted the Corporate Affairs Manager Ms. Juliana White in reviewing the BSE's Professional Indemnity Insurance, Blanket Bond and Computer Crime Proposal Form from AON Botswana (Pty) Ltd.
3. The CARANA Team provided policy advice and recommendations on day-to-day operations of the BSE; i.e., insider trading case, public education initiatives, revenue generating opportunities, review of Central Securities Depository Act and Central Securities Depository of Botswana Charter.
4. The CARANA Team assisted the BSE in preparation of a tender for modifications of USAID-provided registry system for installation at the BSE to support the re-registration and settlement of Botswana government bonds.
5. The CARANA Team provided policy advice and guidance to Mr. F. Modise, Secretary for Financial Affairs, Ministry of Finance and Development Planning. On a regular basis, not daily necessarily, but certainly at least weekly or twice a week, Mr. F. Modise called on the CARANA Team to advise him on specific matters, often requiring memos or explanatory notes. USAID as well as CARANA Corporation (Stanley Mupanomunda) was kept apprised of this work and advisement that took away from my drafting of legislation.
6. Memos and notes discussed with and delivered to Mr. Modise included topics on:
 - a. A memo to Mr. Modise, reviewing the CARANA Team (Rick Dvorin and David Wall's) scope of work, including initial recommendations (July 14);
 - b. A memo to Mr. Modise, stating the need for the Legislation of Botswana to be amended, through a new law or regulation on the listing and trading of government securities, as Mr. Modise was preparing for a meeting with the Minister to discuss these topics (July 23);
 - c. A memo to Mr. Modise on the current or potential problems in BSE Act (the "Act") and BSE Members Rules ("Rules") for trading government bonds on the BSE (July 23);
 - d. "Central Depository Act and Proper Procedures for Government Bond Trading" (July 23);
 - e. Summary of the Ministry's Division of Financial Affairs "Strategic Plans, April 2002-March 2005", highlighting the areas of priority and importance (August 25);
 - f. "Capacity and Organization of Ministry for Regulation and Enforcement of Securities Market" (August 29) which include the need for the Ministry to expand their capacity (staffing and training) in the area of regulation and enforcement;
 - g. Preparation of the draft cabinet memo for Mr. Modise, explaining to the cabinet why the draft Securities Act is needed and the principles that are included in the draft Act (September 4);
 - h. Memo to Mr. Modise, "Supervision of Brokerage Firms, Stockbrokers, and Securities Depositories, Registries, and Settlement Systems" (September 4)...again relating to the capacity needs of the Ministry and the needs to have securities markets and professional

participants of the securities markets supervised by the securities regulator, i.e., the Ministry rather than by the Bank of Botswana;

- i. Speaker notes for Mr. Modise, to speak at the Capital Markets Workshop on September 9 (prepared September 4), but unfortunately, Mr. Modise could not attend the seminar; these (edited) notes were read by the Deputy Chairman of the BSE Committee at the workshop; in addition to presentations to the workshop; and
 - j. Speaker notes and PowerPoint presentation for the September 9 workshop, presented to over 60 participants from the financial markets.
9. Formal meetings with the senior staff at the BSE occurred twice per week, with interim meetings and discussions occurring on an ad hoc basis. The topics included:
- a) Progress of the draft Securities Act;
 - b) Progress of the draft Central Securities Depository and Registry draft;
 - c) Re-drafting of the Securities Act;
 - d) Philosophy of operating and regulating a securities exchange;
 - e) Surveillance at the Exchange;
 - f) The need for re-drafting the BSE Listing Rules; Membership Rules; Trading Rules, and drafting rules and procedures on disciplinary actions and dispute resolution process; and
 - g) The time phased implementation plan for launching of government bond trading at the BSE.
10. Regular meetings (e.g., once a week) with Stanley at USAID were held between the CARANA Project Team and Stanley Mupanomunda of USAID, apprising him of our progress, accomplishments and problems and needs.

V. LEADING ISSUES FACING THE EXCHANGE AND RECOMMENDED NEXT STEPS

As discussed throughout this report, the BSE is well on its way towards establishing itself as a commercially viable securities trading mechanism that is capable of trading several types of instruments, is open to all qualified participants, has a high degree of systemic integrity and operates in a transparent fashion. The BSE is staffed with a variety of well-qualified professionals and a solid management team who understand the role of an exchange in a transitional economy.

However, in spite of these attributes, the BSE has some significant hurdles to overcome with respect to its future development and its role in the financial markets of Botswana.

- ◆ Due to time constraints, and other priorities that came up, the CARANA Team was unable to draft the rules for the CSD or the listing and membership rules of the BSE. These are certainly needed, as well as other rules of the BSE that need to be drafted as mentioned above.
- ◆ Time also prevented harmonization of the acts and regulations with:

- Themselves, i.e. references to various and specific sections of the Act and the regulations should be made according to the section number of that Act or regulation;
 - Legislation of Botswana, i.e., the Securities Act must be harmonized with other laws of Botswana, or drafted and to-become-effective legislation of Botswana, such as the Companies Act, the tax laws, competition laws, the bankruptcy acts;
 - Legislation and regulations of other regional or SADC countries. However, please note that the international best practices of my drafted act and regulations must not be compromised for the sake of harmonization.
- ◆ Time constraints limited the ability to fully draft the legislation in an approved format, e.g. including side notes and a proper table of contents.
 - ◆ Review (with the Bank of Botswana) the proposed National Clearance and Settlement Bill, which was scheduled for passage by Parliament and publication in the Government Gazette. In its current form, this bill would seriously undermine the integrity of the capital markets and only further contribute to the fragmentation of the existing legal framework.
 - ◆ The Exchange suffers from a public image problem among domestic investors and businessmen. The underlying reasons for which can be found in the evolutionary history of the BSE (an entity under the stewardship of E&Y). Regardless, the BSE should take a very active role in marketing its success to the local populace in addition to the broader financial media.

While there are several systemic and operational issues, which represent challenges to the BSE, there is no reason to believe that the existing management and staff cannot easily overcome them with the appropriate amount of guidance. Taking this into consideration, we offer the following items as “next steps” for the Exchange to address. Please note, these items are listed in sequence and are not meant to indicate any relevance to priority.

1. The BSE should take active steps towards the development of the Central Securities Depository of Botswana. While this corporate exists on paper, the institutional framework for its existence does not exist. Taking this into consideration, the BSE is seeking to adopt the USAID-provided software to develop its CSD capacity. The staff of the BSE will need to be trained in the operation and development of this software. Separately, detailed action plans for the development of clearance and settlement functionality and training of BSE staff in the management and operation of a CSD will be required.
2. The BSE should take immediate steps to implement a real-time electronic trading system. A stock exchange system that enables the market to more efficiently trade volumes of shares 20 times greater than today's volume with more security and back-up systems. When complete, such a system will facilitate BSE and MOF surveillance by maintaining a reliable audit trail of transactions processed, and incorporate automated, on-line surveillance based on "alert" parameters to flag unusual price or volume changes for a security.
3. The BSE needs on-the-job and extensive training in the operation and oversight function of an SRO. Procedures for on-site, off-site, inspection, surveillance, compliance, enforcement, code of procedures, arbitration, membership, revision of the trading rules, rules for books and records, rules for capital adequacy; and a dispute resolution mechanism including guidelines for appeals and sanctioning.
4. With the launch of government bond trading at the BSE, the BSE should open up discussions with vendors to negotiate contracts for a license fee for last sale information.
5. Steps should be taken to restructure the BSE Committee and Supervisory Board to include for (a) issuers; (b) investors; (c) businesses (legal persons); and (d) stock market participants.
6. The BSE needs to take immediate steps to expand its membership to include direct and non-direct participants (thereby opening up membership to pension funds (159), asset management companies, investment funds, and insurance companies).

7. The BSE needs to revise its fee structure to reflect the reality of increased volume due to trading activity in government bonds and the roll out of a clearance and settlement facility capable of processing registration and corporate actions. Taking into consideration the rules of the market, including fees and rates, should not impose any burden on competition which is not necessary or appropriate in furtherance of just and equitable principles of trade.
8. Separate from targeting select issuers for retention, the BSE should meet with select issuers to discuss stock splits—making their shares more affordable to investors will increase their trading volume, increase their share capital and promote investment in their company.
9. The BSE should draft a “listed-companies manual” outlining reporting requirements and corporate governance requirements of BSE-listed companies.
10. The Ministry needs to expand and improve capacity for operations as a regulator and for enforcement. The staff at the Ministry in the area of capital markets is very limited, both in numbers and in capabilities. The CARANA Team recommended that the Ministry have at least four staff people, not including Mr. Modise, to operate as a regulator and to perform enforcement in capital markets. In addition to the numbers of staff being increased, the staff is and would be in great need of practical, hands-on training, in day-to-day activities, and in the areas of document (e.g. prospectus, financial statements) review, inspections, investigations, and enforcement (e.g. the handling of reports of offences and violations, and the presentation of these reports). Domestic regulation and enforcement of the capital markets cannot take place until this capacity issue is taken care of.
11. The development plan for Botswana calls for the establishment of an independent Financial Services Authority (FSA) to be responsible for all regulation and enforcement of the financial and capital markets’ legislation and participants’ activities. The establishment of the FSA is to be completed by the year 2008; however, there is no definite timeline for this. The need is for the FSA to be established immediately, certainly no later than 2004. Until that time, realistically, the legislation will not be enforced.
12. The draft legislation and the regulations must be sent out to the professional participants of the securities market for their comments, and to help with the harmonization mentioned above. That is, all existing or drafted legislation of Botswana must be harmonized with the Draft Securities Act.
13. Regulations for Investment Advisors and Managers, collective investment schemes and undertakings (i.e., mutual funds, advisors, and fund management companies), and investment companies have been adopted, but again, the Ministry has given the regulatory responsibility to the Bank of Botswana. Best practices state that the Securities Regulator, i.e., the Ministry of Finance, should regulate these financial and securities-related institutions and individuals. While the Division of Financial Affairs has included the set up of the Financial Services Authority (FSA), there is no time line for this, other than meeting the 2008 deadline.
14. Other recommendations included in the memo preceding the Draft Securities Act include the following policy changes:
 - a. All securities issued for public trading will be either immobilized or dematerialized.
 - b. There will be a Central Securities Depository and Registry (CSD) mandated and established, more than likely owned and operated by the BSE.
 - c. All publicly issued and traded securities must be “deposited” and registered with the CSD.
 - d. All publicly issued securities (over 100 shareholders) must be listed on a licensed securities exchange or market.
 - e. The Ministry will have the power and authority to make immediately effective declarations, pronouncements, interpretations, etc. with subsequent publication in the Gazette.

- f. The Ministry will have the powers to delegate enforcement, inspection, investigation powers...to the BSE as a trained and operating SRO; to auditors; to an eventual Financial Services Authority (FSA)...with this last development, a new and brief Act will be required, establishing the FSA and describing its authority.
15. The BSE needs to streamline their current (and recently drafted 200-page+) listing rules and requirements. Listing rules should contain basic information and reporting/disclosure requirements, along with other good corporate governance principles, thus making the Exchange responsible for the regulation and enforcement of listing and corporate governance requirements. The BSE should create a spectrum of listing levels and requirements for various types of companies to be listed for trading. Smaller or venture capital or just formed companies should be able to list, as well as foreign companies, and larger, more mature companies...the latter with more stringent requirements for capital, number of shareholders, and implementation of good corporate governance standards.