Policy Recommendations Adopted by 33rd Session of the COMCEC

- **Strengthening/Setting up an independent Public Debt Management Unit with well-defined functions and a dedicated debt management strategy**

Rationale: In several OIC member countries the delineation of competences between different institutions involved in public debt management remains vague. Especially the partial lack of centralization at a dedicated Public Debt Management Unit (DMU) might prove to be challenging for further management improvements. Therefore, all OIC member countries are encouraged to either set up a new independent DMU or institutionally strengthen an existing one, possibly located at the Ministry of Finance or the Central Bank. Moreover, the development of a formal debt management strategy, including quantitative strategic targets, is recommended. The DeMPA Performance Indicators of the World Bank can serve as an initial reference point. In order to support the transition process, OIC member countries that have already professionalized public debt management practices may advise partner countries in establishing such institutional frameworks. This could include policy recommendations with regards to specific areas of debt management, including but not limited to a long-term strategy development, risk management, debt monitoring or institutional coordination. Besides exemplary institutional settings and public debt management documents, the exchange about challenging experiences and the respective 'lessons learned' might prove to be especially helpful during the process.

- **Developing/improving domestic debt market.**

Rationale: Domestic debt markets are important sources of funding for public budgets. A wellfunctioning, liquid domestic market encourages the investments from domestic creditors due to lower transaction costs and hence provides additional diversification opportunities for the government. As domestic investors tend to react less to the global macroeconomic and financial shocks, refinancing risks may be lowered in addition to a decreased currency risk. However, a number of domestic public debt markets in the OIC member countries still show potential for improvements. Most importantly, strengthening the legal accountability and regulatory frameworks while maintaining political stability is a key aspect for the member countries faced with some political changes in the past few years. Moreover, low and stable inflation rates as well as an independent central bank may help to keep savings in the domestic financial market, which might be especially relevant for the Sub-Saharan countries group. Additionally, governments should reduce their reliance on the domestic banking sector by encouraging institutional investors such as insurance companies or pension funds to participate in the market. Finally, the introduction or further development of Islamic finance instruments, especially Islamic sukuk bonds, can deepen domestic financial markets and mobilize additional financial resources from both, private and institutional investors. Overall, a high share of marketable securities in total domestic debt, a broad participation of different financial agents and a high ratio of fixed versus floating bonds usually describe a sound domestic bond market.

- **Broadening and diversifying the creditor base.**

Rationale: In many OIC member countries, the limited investor base is perceived to be one of the most relevant challenges for realizing efficient public debt operations. Along with an improvement

of domestic debt markets, a further opening towards global markets as well as offering new investment vehicles may address this problem. Generally, the issuance of Islamic sukuk bonds may broaden the credit base as new (international) investors, who are specializing in Sharia-compliant financial instruments, may be attracted. While even non-OIC member countries experience greater popularity of such Islamic sovereign bonds, this development is especially relevant for cross-border investments between OIC countries, particularly through sovereign wealth funds of OIC member states. Moreover, recent innovation efforts such as state contingent debt instruments or Master Collateralized Murabahah Agreements (which are bundled assets based on rent-to-own agreements) might be evaluated in order to broaden the investor base and better management of risks. It should be also noted that to attract international investors, it is crucial to increase the transparency and information availability regarding public debt data, procedures and (predictable) management strategies. It is generally recommended that OIC countries with a yet developing domestic market avoid a large dependence on either domestic or foreign borrowings, but strive for a balanced exposure to both markets to mitigate global macroeconomic as well as country-specific shocks.

- **Lengthening the average maturity of the public debt.**

Rationale: Governments have a tendency to issue short-term rather than long-term bonds. Currently, the average maturity of new external debt commitments of private creditors (excluding official creditors such as the IMF) in the OIC member countries hovers at only 4-5 years, and has even shown a declining trend since 2013. Although interest rates on short-term obligations are usually lower than long-term ones due to an additional maturity premium investors demand for a long tie-up of their capital, a tradeoff arises as short-term debt is subject to a higher refinancing risk. Moreover, the concentration of short-term bonds may prevent the establishment or further development of a domestic debt market which is supposed to satisfy both the investors' preferences and the government's needs for medium- to long-term financing. Hence, OIC member countries which are negatively affected by those factors are encouraged to expand the maturity mix of their public debt portfolio. Especially governments in the high- and medianincome group with access to global debt markets may consider increasing bond issuances with longer time horizons relative to short-term bills if the domestic market conditions permit such operations, given the current period of low interest rates in many developed economies. Overall, it is advisable to exploit the benefits of all maturity categories, from short- over medium to longterm, and achieve a sustainable maturity balance without an exclusive dependence on either one category.

- **Applying macroeconomic risk management methods.**

Rationale: Macroeconomic developments pose a significant risk for public debt management as the respective shocks are often difficult to mitigate in the short-run. Thus, OIC member countries are encouraged to implement quantitative information and analysis systems based on adequate frequency data which provide early warning indications. A basic set of macroeconomic indicators include the ratio of the net present value of debt relative to GDP and government revenues, external debt servicing costs relative to exports or the consolidated general government net lending relative to GDP. Best practices include the OECD System of Composite Leading Indicators which is designed to provide early signals of turning points in business cycles. OIC countries with a high

degree of integration into the global financial system might find the signal approach methods (such as ifo Signal Approach) helpful, which assesses the probability of a currency and banking crisis. Nations which have a high natural disaster risk may consider negotiating standing backup credit lines for immediate release of additional funding. Finally, the public budgets in many OIC the member countries strongly depend on commodities which are prone to global macroeconomic shocks. Especially the recent decline in oil prices has led to a strong increase in newly issued public debt in some member countries. Concerned countries should aim to diversify their economic activities into less volatile sectors, which admittedly differ from case to case. Overall, synergies from macroeconomic risk management may be achieved if the responsible authorities built strong communication and coordination channels with the DMU.

- **Improving the Islamic Finance Infrastructure through Developing Necessary Legal/Regulatory Frameworks for its each Component namely, Islamic Banking, Islamic Capital Markets and Takaful towards Creating an Enabling Environment for Islamic Finance.**

Rationale: Islamic finance is still at the early stages of its development in many OIC member countries compared to its conventional counterparts. Considering its potential, Islamic finance needs a conducive and enabling environment to realize its potential. It is a known fact that the countries having a strong legal environment during the early stages of the development of an industry tend to show significant progress compared to countries with insufficient legal infrastructure. In this regard, legal infrastructure constitutes an important condition for the development of the sector in any jurisdiction. The legal infrastructure should include, not only a general law but specific legal frameworks for each component of the Islamic financial sector namely; banking, capital markets, and takaful. The following specific items are of particular importance under the development of a legal system for any jurisdiction: (i) Separate Islamic Banking, Islamic Capital Markets and Takaful Law to allow for registry and operations of the companies. (ii) Taxation law to allow for a level playing field, or preferential treatment to Islamic financial products to encourage the market players to move towards Islamic finance. (iii) The legal framework for dispute resolution and arbitration. In almost all Islamic finance jurisdictions there is a need for dispute resolution centers which are governed by the Islamic law. (iv) Develop a general Islamic bankruptcy framework for the corporate sector.

- **Developing a Sound and Effective Governance Framework for National and Strengthening Coordination of Shariah Governance Standards and Policies across Different Jurisdiction.**

Rationale: Developing a sound governance framework at the national is of particular importance for developing Islamic Finance Industry. The following specific points can be taken into consideration while creating such a framework: (i) Shariah governance standards and framework should be incorporated in the Islamic financial law. (ii) There is a need for the further development of the Shariah governance standards especially for the takaful industry and the Islamic capital markets. Some of the global standard-setting organizations at global level such as the AAOIFI and IFSB have already issued standards which can be utilized by the OIC member countries. (iii) The existence of an independent national level advisory board can help coordinating the rules and

regulations related to the Shariah governance and minimize diversity of different practices among the member countries. Since Shariah compliance is the unique differentiating factor for Islamic finance, there is also an immediate need for coordinating different Shariah Governance Frameworks among the OIC member countries to ensure that theproducts and operations of Islamic financial institutions do not contradict with the principles of the Islamic Law. Policymakers of the OIC countries need to ensure a sound governance framework by making it a legal/regulatory requirement.

- **Establishing/Developing Islamic Finance Rating Standards**

Rationale: With the evolution of Islamic financial instruments and more focus on risk-sharing, Islamic financial transactions require a newer set of rules of book-keeping and financial reporting. A global adoption of Islamic finance accounting and reporting standards like AAOIFI is crucial for further development of the sector while ensuring transparency and disclosure in the financial reporting. A set of harmonized standards is a pre-condition for providing innovative Islamic financial instruments. While there have been efforts in this regard by AAOIFI and IFSB, there is an urgent requirement for developing detailed standards for greater Shariah compliance disclosure and a wider acceptance of these standards by the OIC member countries. In this regard, the focus can be given to develop rating standards which would help investors. While conventional rating agencies have been interested in rating for Islamic financial products, there is a need to increase and spread the rating efforts of the specialized Islamic finance rating agencies across the OIC Region.

- **Strengthening Human Capital in Islamic Finance in the OIC Member Countries through Enhanced Financial Literacy and Awareness Programs/Projects by Governments, Universities and Private Sector**

Rationale: Provision of adequate and trained human capital is critical to the sustainable growth of all Islamic finance sub-sectors. At the public level, governments and regulators can take initiatives to establish educational, training and research centers. Private institutions such as research and training institutions, advisory firms and trade associations can contribute to for the development of human capital. Universities and academic institutions can also play an important role not only in providing education and training in Islamic finance but also in conducting research that can support the industry.

- **Facilitating Experience Sharing among the OIC Member Countries in subsectors of the Islamic Finance Industry for a Sustainable and Harmonized Growth of the Industry**

Rationale: Some OIC member countries have taken the lead in developing the Islamic financial infrastructure and regulations. In this respect, experience sharing in the following areas among the Islamic finance destinations in the OIC Region among others: (i) Experiences related to policy development and regulatory framework enhancements (ii) Practices related to innovative sovereign sukuk issuance attracting retail investors for infrastructure development. (iii) The best practices and implementations of some member countries in the area of liquidity management