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Overview – Palestine
Jurisdiction Update Palestine

Securities and Banking Overview

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The PSE saw Al Quds Index shedding 12.8% in 2007 compared to losses of 46.4% in 2006. Losses continue to accumlate during the first eight months of the year, with the index reaching a low level of 408.10 pts on August 26, 2007 before recuperating toward the year end to close at 527.26 pts.

The year 2007 witnessed a large increase in the total number of traded shares with 299.4 million shares exchanging hands, up by 34.5% from the 2006 level of 222.7 million shares. However, the value of traded shares declined by 23.8% reaching JD576.4 million compared to JD756.4 million in 2006. This came due to the combined effect of an overall decline in share prices along with active trading on the newly listed shares with relatively low share prices in absolute term. The PSE's total market capitalization declined by 9.3% to stand at JD1.75 billion at the end of the year, representing around 58.9% of estimated real GDP for 2007.

Many listed companies at the PSE showed an improvement in their bottom line figures for the first nine months of 2007, being able to recover the investment losses incurred in 2006 that resulted form the steep market slump. According to the companies' nine months financial statements, 26 companies, out of the 35 listed companies, posted profits amounting to around JD90.7 million for the period. Meanwhile, only 9 companies recorded losses reaching JD1.3 million for the same period. Based on the companies' 12-month trailing net income, the market P/E stood at 14.01x at the end of 2007 compared to around 17.00x at 2006 year-end.

At the beginning of 2007, the PSE started to publish the indices for each of the five economic sectors represented in the market, in order to enhance the representation of the market performance. In terms of market capitalization, the services sector had the largest weight representing 41.3% of total market capitalization at the end of 2007. The investment sector came next with a 29.2% weight, followed by the banking sector with a weight of 17.4%. The industrial and insurance sectors are smaller in size, comprising 8.4% and 3.7%, respectively, of total market capitalization at the end of the year. However, the market is dominated by three companies, which comprise more than 65% of total market capitalization combined.These companies are, in order: Palestine Telecommunication Company 'PALTEL.PL', Palestine Development and Investment Company 'PADICO.PL' and Bank of Palestine'BOP.PL'.

The constituents of Al Quds index were also adjusted at the beginning of 2007 to cover 12 companies by adding Golden Wheat Mills Company 'GMC.PL' and National Insurance Company 'NIC.PL'. This came to give better representation of the market performance.

By the end of the year, the number of listed companies grew to reach 35 companies, from a total of 33 companies at the end of 2006. Three new companies entered the market, Al Rafah Microfinance Bank 'AMB.PL', the Palestinian Distribution & Logistics Services 'WASSEL. PL' and Union Construction & Investment 'UCI.PL', while Palestine International Bank 'PIB.PL' was de-listed from the PSE on June 24, 2007 as it has been suspended from trading since October 2005, due to irregular disclosure of its financial results.

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The year 2007 also saw the transformation of the PSE from a private to a public shareholding company, to become the second bourse in the Arab world to take this step after Dubai Financial Market (DFM). The PSE, which has a current paid-up capital of USD10 million, will undergo an IPO whereby 3 million shares, representing 30% of PSE's capital will be offered to the public, while another 7% will be allocated to Palestinian financial brokerage firms and 3% to the PSE's staff at an expected price of USD6 per share to all parties.
Significant developments took place in the stock market during the past year, as the PSE and the Palestine Monetary Authority (PMA) reached an initial agreement to take several measures in efforts to support the liquidity in the stock market. At the forefront, the two parties agreed on allowing banks operating in Palestinian Territories to extend facilities for equity trading purposes. Various measures were also taken to facilitate the receipt of incoming wire transfers for the purpose of purchasing stocks, in addition to encouraging banks to set up investment funds, which will inject new liquidity to the stock market. Moreover, the PSE started executing online trading transactions in April 2007 and signed a number of agreements with brokerage firms to provide online stock trading services.

Building Hope from Rubble…

After several clashes between Hamas and Fatah early in 2007, the two parties, under heavy diplomatic pressure especially from Saudi Arabia, were made to bridge the gap and started negotiations on forming a national unity government, but again they failed to reconcile their differences leaving the Palestinian Territories divided, with Hamas in control of Gaza and Fatah retaining control of the West Bank.
As a result, the Palestinian President Mahmoud Abbas dismissed the national unity government and announced the formation of an Emergency Government in June 2007 until the conditions are right for new elections. The Quartet (United States, the European Union, Russia and the United Nations) has normalized relations with the new Government and agreed to lift the economic and political embargo against the Palestinian Authority (PA) that had been in place since Hamas came into power early in 2006. Moreover, Israel agreed to unfreeze around USD700 million in withheld Palestinian tax revenues, the most of which were transferred to the PA toward the end of 2007.
In November 2007, Palestinian and Israeli leaders agreed at the US-sponsored Middle East peace conference in Annapolis to try to forge a peace treaty and create a Palestinian state by the end of 2008, just before US President George Bush leaves office. However, the conference was a big disappointment to Palestinians with the absence of any practical improvement on the ground. This conference was followed by an international donors' conference in Paris, in which 68 countries were keen to extend around USD7.43 billion in donations to revive the Palestinian economy.
Nevertheless, the prospects for Gaza remain uncertain. However, its fall could open the way for what has been called a 'West Bank First' approach. The international community would inject considerable sums of money into the West Bank, promote reform of the PA, help to rebuild Fatah's security forces and encourage Israel to engage in meaningful final status talks. It is hoped that the progress to be made in the West Bank would contrast

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strongly with the privations of Hamas-controlled Gaza, leading Palestinians to rally around Fatah.

Road to Recovery…

The deteriorating situation in the Gaza Strip has widened the gap of economic well-being between Gaza and that of the West Bank. The current closure policy in Gaza due to Hamas illegal takeover has eroded its economic backbone in a way that is difficult to reverse.
According to official statistics, the restrictions have led to losses of around USD70 million during the first five months, after which Hamas took control over Gaza, the closure of 95% of total industrial establishments and a 7.9% increase in the Strip's poverty rate. In order to revive the Palestinian economy, the PA announced a Palestinian Reform and Development Plan (PRDP) aimed at increasing revenues, reducing expenditures, and introducing sector reforms to enhance efficiency. With about 40% of the population, Gaza Strip is an integral part of the Palestinian Territories and economy; therefore any economic recovery attempt could be hampered by the current closure regime in place.
Despite economic turmoil, the real GDP for 2007 is expected to reach USD4.2 billion, a 2.3% growth compared to 2006. The Palestinian economy grew at an average annual rate of 8% between 2003 and 2005. Had that trend continued through 2007 in the absence of Israel's restrictions, the country's real GDP may have registered more than double the estimated value.

In Palestine, banking is regulated by the PMA. There are currently 21 banks in West Bank and Gaza, including 17 commercial banks, 3 Islamic banks, and 1 development bank. There are 8 Jordanian banks, 2 Egyptian banks, 1 large international bank, and 10 Palestinian banks. All foreign banks operate as branches.

The Palestinian Monetery authority is Palestine's "Central Bank" and is responsible for its monetary policy, bank notes, financial system and funds management. As set out in the, Decree No. 184 of 1994 establishing the Palestinian Monetary Authority " The objectives of the Monetary Authority are ensuring the soundness of banking operations, maintaining monetary stability, and encouraging economic growth in Palestine, in accordance with the general policy of the National Authority "

The Palestine Monetary Authority (PMA) is the emerging Central Bank of Palestine. Its overall purpose is to assist in the maintenance of the stability and effectiveness of the Palestinian financial system, Promote sustained economic and financial growth of the Palestinian economy through the following:

1. Effective and transparent regulation and supervision of Banks operating in Palestinian Territory;

2. Development of Monetary Policy designed to achieve price stability;

3. Overseeing the implementation and operation of modern, efficient payment systems.

The PMA was initially established in 1995 by presidential decree as an independent institution and later by an act of the Palestine Legislative Council PMA Law Number (2) of 1997 which outlined the full authority and autonomy of the PMA.

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Banking

1. The PMA Law and the Banking Law establish the PMA as the regulator for banks. The Banking Law requires that banks must be joint-stock public companies in accordance with law in effect in West Bank and Gaza. Foreign banks and jointly-owned banks are exempted from this requirement.

- Applicants for a license need to demonstrate compliance with the banking law, directives, instructions, and decisions in force in West Bank and Gaza and must satisfy any condition or request that the PMA deems necessary.

2. The Bank Supervision Department (BSD) of the PMA. It employs both off-site and on-site supervision methodologies in its regulation of banks. At the operational level, the department has units which have responsibility for commercial and Islamic banking.

3. On-site supervision is centered around annual visits to banks but the frequency of such visits can be increased when it is judged necessary to do so.. The BSD indicates that over the past 3–4 years, there has been a noticeable improvement in the banks' compliance with international Anti-money Laundering and Combating the Financing of Terrorism (AML/CFT) standards. Off-site supervision is largely based on the submission of call reports by banks that are currently submitted to the BSD on diskette.

4. The BSD indicates that it devises a general supervisory strategy for each bank which includes issues related to the management of ML/FT risks. Banks are expected to establish systems to meet requirements of the Financial Action Task Force (FATF) recommendations. In undertaking a Customer Due Diligence (CDD) for new customers, the BSD expect banks to record information such as the applicant's name and address, type of business, economic sector, type of job, and the amount of funds expected to be transferred from abroad. The BSD has developed a checklist to be used by its staff during on-site inspections to review banks' compliance with KYC standards. In reviewing the

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monthly call report submitted by banks, the BSD tries to verify that reports of funds transfers are consistent with the information sent to the Financial Follow Up Unit (FFU).

5. Banks have internal systems and controls established to address the needs of their overall banking operations which could become vital components of their AML regime. While one institution indicated that it employs a staff of 25 persons to address AML/CFT compliance issues, their focus is exclusively on monitoring transactions in the context of the limited reporting requirements of the FFU.

6. Both institutions reported that their AML/CFT systems have been reviewed by the PMA during the course of on-site inspections. Such inspections have been conducted at least once a year. One bank has had three AML/CFT inspections from the BSD over the course of the last 12 months.

7. Significantly, both institutions indicate a reluctance to offer banking services to money changers. One institution no longer offers banking services to these persons while the other does so on a very selective basis. This creates a situation in which MCs are likely to move to other institutions or devise other means of accessing the banking system.

The Banking Sector

The banking system consists of the Palestine Monetary Authority (PMA) – the highest banking authority and regulator – and 11 local banks operating through 81 branches and offices across the West Bank and Gaza. These banks operate alongside with 11 foreign banks possessing a local network of 74 branches.

The sector witnessed developments in 2007, foremost of which was the resignation of the Governor of the PMA, Dr. George Abed in December 2007, after serving around 2.5 years in the post, during which the PMA managed to finalize the first phase of its transforming plan into a central Palestinian bank. President Abbas approved the resignation of Dr. Abed after a turbulent term in which the Palestinian economy came under unprecedented pressure. Dr. Abed was succeeded by the former Deputy Governor Dr. Jihad Al Wazir, who officially started his term on January 1, 2008.

The PMA issued instructions to raise the minimum capital requirement for banks from USD20 million to USD30 million by the end of 2007, which was postponed to become effective on March 31, 2008. Moreover, the PMA issued new regulations allowing banks to extend loans to finance the investment in shares.

In line with the PMA's new regulations, the Arab Islamic Bank 'AIB.PL' increased its paid-up capital in 2007 from USD22.2 million to USD35.5 million, through a right issue of USD11.2 million at USD1/ share and stock dividend of USD2.1 million, leaving the Commercial Bank of Palestine 'CBP.PL', which has a paid-up capital of USD20 million, as the only bank with a paid-up capital below the minimum capital requirements.

In spite of internal instability, a number of banks continued their expansion plans and extended their presence in the Palestinian Territories by opening new branches during last

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year. Al-Quds Bank for Development & Investment 'QUDS.PL' opened a new branch in Atill village near Tulkarem, bringing its total branches to 10. Moreover, BOP opened two new branches in Ramallah and Hebron, bringing its total branches and offices to 30. While new branches were opening in the West Bank, worries dominated that some banks in Gaza could be forced to shut their branches after Hamas took full control and Israel began its financial embargo. For instance, BOP relocated its headquarters from Gaza to Ramallah.
The 42 bank branches in Gaza are suffering from the deteriorating economic conditions, the sharp drop in imports and exports and the limitations on the supply of shekels used for dayto-day transactions.
The PSE banking sector, which comprises of 6 listed banks, witnessed buoyant trading activity last year as it ranked first in terms of traded volume, capturing a share of 44.4% of the overall market trading volume. The sector's index recorded a drop of 14.4% to wrap up the year at 81.52 pts. However, the sector's market capitalization increased by 3.9% reaching JD304.5 million due to the listing of capital increase shares in addition to the listing of AMB with total listed shares of 30 million.
AIB – accounting for 36.5% of the sector's total trading volume – topped the market gainers' list by adding 61.8% to close at USD1.99. AIB's net income after tax for the periodending on September 30, 2007 more than doubled to reach USD3.23 million compared to the corresponding period of 2006, which together with an increase in capital brought the bank's shareholders' equity up to USD39.10 million at the end of September 2007 from its 2006 level of USD25.83 million. On another hand, the sector's least active share, Palestine Investment Bank 'PIBC.PL', fluctuated over a wide range between USD2.85 and USD1.20 during the past year, before closing at USD1.70, down by 41.8% for the year thus ranking third among top losers in the top five losers' list.

Capital Markets

8. The Capital Markets Authority (CMA), which was recently established as a regulatory agency, has responsibility for the securities market, insurance, and financial leasing and mortgage enterprises. Prior to the advent of the CMA, the Ministry of Finance had notional oversight responsibility for capital market licensees. The Palestine Securities Exchange and the Capital Markets Authority are jointly responsible for supervising the activity of brokers.

9. The securities law requires that entities engaging in security intermediation or providing financial investment advice or fund administrator services must be licensed by the CMA. The law provides that the CMA shall issue instructions on the licensing procedures, qualification requirements, the management, and professional and technical qualification for applicants.

10. The law empowers the CMA to request licensees to provide it with any information and reports about their operation as may be required. The CMA also has the

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ability examine the facilities, accounts, books, and records of licensees. The CMA can suspend or revoke a license. As it is a very new institution, the CMA has not yet recruited staff and has not commenced its supervisory activities.

11. The PSE's Surveillance Department monitors trading on a daily basis to determine instances where activity is in breach of the exchanges' rules. It was reported that this surveillance is also used to verify that trades undertaken are consistent with the profile of the person on whose behalf the trade is executed. The mission's discussions suggest that to date, only minor violations have been identified.

12. The exchange expects that brokers will undertake CDD on their customers. The exchange checks the CDD documentation obtained by the brokers and will periodically visit the brokers to view their operations. These visits, however, are not equivalent to full inspections of the brokerage houses and are, therefore, not a useful mechanism for assessing the effectiveness of any AML/CFT measures.

- If the agent or broker violates the provisions of this Law or the codes of conduct issued pursuant thereto or the instructions, decisions or orders issued by the Authority or the Director General;
- If he is convicted of an offense involving fraud or dishonesty whether or not in connection with an insurance matter; or woundup

The Insurance Sector

13. The insurance law establishes the CMA as the regulator of insurance companies, agents, brokers, and actuaries. The law provides for the CMA to issue licenses to each of these entities. The law also provides that the Director General of the CMA should submit to its board, not more than six months after the effective date of the law, draft regulations that relate to the licensing conditions and other requirements for licensees. The six month period since the date at which the law became effective has not yet expired, so the regulations are not yet in place. Insurance entities were previously regulated by the MOF.

14. The law requires licensees to provide the CMA with such information as it shall request and provides that the CMA may also require at anytime that an audit be undertaken of all files, records, and documents of licensees.

15. The CMA can suspend a license if a licensee is in breach of the provisions of the law or rules, regulations, or instructions issued thereunder in the following circumstances:

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- If the agent or broker violates the provisions of this Law or the codes of conduct issued pursuant thereto or the instructions, decisions or orders issued by the Authority or the Director General;

- If he is convicted of an offense involving fraud or dishonesty whether or not in connection with an insurance matter; or

- If he is or was a director of any company involved in insurance which has been wound up.

The insurance sector is regulated by the Palestine Capital Market Authority (PCMA), which controls 7 local insurance companies (operating in 47 branches) and 2 foreign companies (operating in 9 branches). The sector still lags behind other financial sectors despite many attempts to improve it.

The PSE insurance sector, comprising of 4 listed companies, was the worst performer last year, recording y-o-y losses of 40.3% in its index to close at 77.50 pts. Likewise, the sector's market capitalization showed the largest drop of 40.4% in 2007 reaching JD64.2 million compared to JD107.9 million in the previous year, thus accounting for 3.7% of total market capitalization.

Despite increasing by 66.3% over the previous year, the sector is still characterized by thin trading volumes as only 8.48 million shares exchanged hands last year, representing a mere 2.8% of total market trading volume. Moreover, more than 95% of the sector's trading volume was captured by the Ahleia Insurance Group Company 'AIG.PL', which suffered the biggest losses across the market, shedding more than 50% of its value to end the year at USD1.48. It is worth mentioning that AIG is currently the only insurance company included in Al Quds Index after excluding NIC on January 2, 2008.

In sector related news, the PSE adjusted the number of shares of Al Mashriq Insurance Company 'MIC.PL' from 4.4 million shares to 6.2 million shares, following the company's decision to change its par value from JD1.00 to USD1.00, such that its market capitalization remains unaffected.

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