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Middle East and North Africa Securities Finance Guide 2019

BUILDING UP THE FOUNDATIONS

Securities lending in MENA: The current state of play

SHARIA-COMPLIANT REPO

HOW COULD ALTERNATIVE REPO-LIKE STRUCTURES SUPPORT LIQUIDITY MANAGEMENT?

+ COUNTRY PROFILES

The latest securities finance developments in the region’s key markets

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Firming up the foundations for securities lending in MENA

Matt Smith reports on the progress that has been made in implementing securities lending and borrowing in the Middle East and North Africa.

Long touted as a means to deepen Middle East stock markets and attract more foreign money, securities lending and borrowing remains in its infancy in the region. Yet behind the scenes, brokers and asset managers say significant steps are being taken to realise these ambitions.

Such plans are part of a broader effort to put the Gulf on international investors' radar. Influential index compiler MSCI upgraded Qatar and the United Arab Emirates to emerging market status in 2014 after the two countries' bourses and regulators undertook myriad reforms that were prerequisites to achieve such a classification. These included changing the settlement process and making stocks more easily accessible to foreign investors.

Saudi Arabia and Kuwait completed similar modifications to achieve the same – Saudi joined MSCI's Emerging Market Index in May 2019, while Kuwait will become a member next year. The four Gulf countries are now also all part of the FTSE Russell Emerging Market Index. Egypt is in both benchmarks too.

Yet for all these improvements, Middle East bourses remain largely long-only markets, with securities borrowing and lending and short selling little used despite efforts to create the necessary infrastructure and regulations to permit such practices.

"The Middle East is strange in that it's home to some of the world's largest sovereign wealth funds, who are very experienced international investors and use securities borrowing and lending in the markets in which they invest, yet their local markets are still relatively underdeveloped," says Andrew Dyson, chief executive of the International Securities Lending Association (ISLA).

The influx of passive, and to a lesser extent, active foreign funds in the wake of the emerging market upgrades has steadily lessened the influence of still-dominant retail traders.

"Retail investor activity will continue to decline in significance," says Ibrahim Masood, chief investment officer at Aventicum Capital Management Qatar, whose major shareholders are Qatar Investment Authority and Credit Suisse. "Nevertheless, introducing short selling into markets where retail investors account for 70-80% of trading will require very robust regulatory frameworks – what are the margin requirements, how much collateral do you need, etcetera."

Lacklustre trading remains a problem on Gulf bourses as tougher regulations deter speculators, while retail investors are still scarred by the steep declines from the late 2000s onwards – as of August 11, Saudi's bourse was trading 59% below its record high, while Dubai is down by more than half from its all-time peak. Abu Dhabi, however, hit a record high in April 2019.

"To make these markets really work you have to have good liquidity - the exchanges are alive to these issues. There's an understanding that if you want to have a broad capital market structure you need liquidity, and a lot of liquidity comes from securities lending-type activity," says ISLA's Dyson.

"It's not just covering short positions. Lending also facilitates market making – if you're going to have a good two-way market, it's vital that market makers can trade knowing they've got access to securities lending pools if they have to fulfil a sale where they didn't have a security in their inventory."

The UAE

Securities borrowing and lending has been permitted on the Dubai Financial Market (DFM) since June 2014, with short-selling regulations introduced in January 2018.

Short selling is restricted to stocks that meet various criteria including a minimum trading volume and for at least 50% of a company's shares to be free float. As of July 2019, just 11 listed DFM companies were eligible. These include Emaar Properties, Dubai Islamic Bank, and construction firm Arabtec Holding.

A DFM spokeswoman says securities borrowing and lending was "still very minimal because regulated short selling has not taken off yet", also noting that no regulated short sales transactions had yet been completed through the exchange.

"In terms of stock borrowing and lending, there are ways that it can happen. One is

"It may appear that the region hasn't made enough progress, but behind the scenes there's a lot of work being done. Now, the bits that are outstanding aren't so complex or difficult to achieve."

- Ibrahim Masood, chief investment officer at Aventicum Capital Management Qatar.

the regulated way, with a few companies in the UAE licensed to provide such services," says Mohammed Yasin, chief strategy officer at Abu Dhabi's Al Dhabi Capital. "But the inventory they have isn't substantial or much used. The over-the-counter (OTC) market for stock borrowing and lending precedes the regulations and is much larger and more established. It's a more efficient way for these institutions to lend and borrow stocks."

OTC borrowing and lending is unregulated which brokers prefer because it enables them to retain control of these assets.

"If they do it via an exchange, they would need separate custodian accounts and there's certain reporting standards, which adds cost and makes it less efficient," says Yasin. "I don't see the two paths converging. I doubt the regulators have the appetite to push OTC providers to do it on the exchanges."

The Securities and Commodities Authority (SCA), which regulates the DFM and Abu Dhabi Exchange (ADX), published requirements for securities borrowing and lending in 2012, restricting short selling to market makers.

In 2015, National Bank of Abu Dhabi – now part of First Abu Dhabi following its merger with First Gulf Bank – became the first UAE institution to be licensed to conduct securities borrowing and lending.

"Regulated stock borrowing and lending will be done more by individual investors - retail and high net worth - but the bigger inventory will continue to be OTC," says Yasin.

Currently, investors wanting to do regulated securities lending in the UAE must have a short-selling account into which securities they borrow are transferred before they can then sell them. "This isn't the most efficient or practical method," says Aventicum's Masood.

Saudi leads?

Having permitted foreigners to directly own Saudi listed shares in 2015, the kingdom has rapidly sought to open up its financial markets to international investors.

As of the end of July, over 1,305 qualified foreign investors (QFIs) had been approved to trade Saudi stocks, the kingdom's bourse told Global Investor. Foreigners were net buyers of more than 51 billion riyals of Saudi shares in the first four months of 2019, while their presence could become even greater after Saudi in June removed a cap on strategic foreign investors that could lead to local companies becoming majority foreign-owned.

Meanwhile, Saudi's fledgling Securities Clearing Center Company (Muqassa) will launch operations once it receives all the necessary regulatory approvals, which are expected before the end of 2019. It will first clear index futures contracts before providing clearing for equities, sukuk, bonds, ETFs and REITs next year. Muqassa is slated

"It's not just covering short positions. Lending also facilitates market making – if you're going to have a good two-way market, it's vital that market makers can trade knowing they've got access to securities lending pools if they have to fulfil a sale where they didn't have a security in their inventory."

- Andrew Dyson, chief executive of the International Securities Lending Association (ISLA).

to start clearing derivatives in 2021.

"That [Muqassa] and omnibus structures are the missing links," says Aventicum's Masood.

"Currently you can't do post-trade allocations from an omnibus account. These sorts of things need to be implemented for short selling to become practical."

Yet he also describes Saudi as "a matter of time" before the required reforms are implemented.

"That, in turn, will probably spur other Gulf markets – particularly Dubai, Kuwait and possibly Qatar – to implement the necessary infrastructure to do likewise," says Masood.

"It may appear that the region hasn't made enough progress, but behind the scenes there's a lot of work being done. Now, the bits that are outstanding aren't so complex or difficult to achieve."

ISLA has been advising the Saudi bourse on how best to facilitate securities lending and short selling. The kingdom will ease restrictions on institutions permitted to lend securities to enable foreign institutions to do likewise, says ISLA's Dyson.

"While there are very good reasons for having rules stating you must have a particular account or be a certain type of institution to undertake a particular function, we're trying to talk to the appropriate authorities to show them that there could be a more efficient way of getting things done," says Dyson. "I wouldn't underestimate these challenges, but they're all resolvable."

Egypt

In Egypt, regulations to govern securities borrowing and lending have yet to be published, although the regulator has approved the concept of short selling and has issued brokers with short-selling licences ahead of its introduction.

"We're still in the process of preparing the market participants," says Amr Abol-Enein, managing director and head of asset management at Cairo's CI Capital, which had 9.1 billion Egyptian pounds in assets under management (AUM) as of June 2019.

"We're explaining the concept to our clients as we await the final phases of the regulations' implementation mechanism – I would expect these to be released in Q4. Five or six brokers have been approved to do borrowing and lending and short selling."

Enabling short selling will help increase the attractiveness of Middle East markets, especially to institutional investors, enabling them to both increase returns and hedge positions, providing an incremental revenue stream for long-term investors who lend their stocks.

"An underlying cause of market volatility is the fact that markets are essentially long-only – moves tend to get exaggerated because your only options are to be in or out of the market," adds Masood. "A common objective of short selling is not just to have a naked short but to hedge your long exposure as well. Once you can short sell, you can participate on the way down as well." ■

KIA looks to remain at the forefront of securities lending

Joseph Thomas, investment accountant specialist, tax and securities lending at Kuwait Investment Authority, talks to Global Investor's **Louise Fordham** about how the sovereign wealth fund works with custodians and agent lenders to explore new opportunities and maximise its lending opportunities.

The Kuwait Investment Authority (KIA) was officially established in 1982, although its history dates back to 1953 with the founding of the Kuwait Investment Board.

The sovereign wealth fund has a subsidiary in London (the Kuwait Investment Office or KIO) and a representative office in China. KIO comprises an in-house investment team which trades directly, while KIA invests through external fund managers out of Kuwait.

The organisation has responsibility for managing Kuwait's General Reserve Fund (GRF), which invests in Kuwait and elsewhere in MENA, as well as the Future Generations Fund (FGF). FGF is managed by both KIO in London and KIA in Kuwait, with investments focused outside of Kuwait in the US, Europe, and emerging markets across multiple asset classes.

"We look at securities lending as a major revenue earner, although we ensure it is not at the expense of securities being made available to managers."

KIA has been engaged in securities lending outside of its local market in Europe, Asia, emerging markets, and the US for a number of years, including the lending of specials. Joseph Thomas, investment accountant specialist, tax and securities lending at Kuwait Investment Authority, says: "We look at securities lending as a major revenue earner, although we ensure it is not at the expense of securities being made available to managers so if there is a requirement from the front office for trading or another manager requirement for the portfolio then we make the securities available to them."

Securities lending is conducted via the sovereign wealth fund's custodians and lending agents. The KIA's Investment Accounts Department (IAD) has responsibility for activities associated with the securities lending programme with lenders. "Maximising returns, collateral sufficiency, and indemnification are the three pillars upon which we build our lending activity with lending agents," notes Thomas.

Thomas explains that KIA's relationship

with its custodians continues to deepen and develop in response to changing regulations and new opportunities, while always remaining in line with the organisation's investment guidelines for stock lending.

"We have seen stock lending evolve in a very fruitful manner for KIA, with lending agents exploring new and different things, such as the pledge structure," he says. "We haven't implemented this yet but we are looking into these kinds of opportunities to get demand among borrowers for our securities. These types of developments are key elements in making sure our securities are linked with the best revenue optimisation possible."

KIA also works closely with its custodians and agent lenders to remain ahead of the curve and aligned with industry best practice. "One of our custodians has a state-of-the-art product which gives us a very transparent picture of our lending structure. This allows us to more closely monitor what is happening behind the scenes, and we can see in a transparent fashion what the revenue is and where we are getting that revenue from," explains Thomas. "These kinds of state-of-the-art systems that our custodians use help us to understand whether we are attaining our utilisation levels on securities and how each custodian or agent lender compares with its competitors."

The Kuwaiti sovereign wealth fund also draws on its relationship with custodians to gain additional market insight and to ensure it has the right information to hand to inform decision making. "It's good to see who the borrowers in the market are, which securities are in demand, if there are limitations around lending a security in a particular market, for example," notes Thomas. "This information provides value."

KIA also places value on remaining up to date with the latest developments by exchanging ideas at industry conferences. "They are something we take a lot of interest in and have representatives attending," Thomas says.

When it comes to securities lending, the organisation remains open to exploring new ground. As Thomas notes: "KIA has been a frontrunner in terms of understanding and being actively involved in securities lending. We are always open to trying new things; if they are beneficial to KIA then we look forward to harnessing the maximum benefit from them, as long as they are within the principles of our investment guidelines and the risk strategy that we have in place." ■

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Tapping into the growing momentum of the MENA markets

Loic Lebrun, Head of Prime Finance EMEA at HSBC, explains the importance of MENA within the emerging markets space, and looks at how the changes in market infrastructure combined with the work being done by HSBC and other industry players, are supporting the development of the securities finance markets in the region.

Any analysis of MENA is bound to start by acknowledging that the region has come a long way in a short amount of time. Just two years ago, it accounted for less than 1% of the global MSCI emerging market index[1], but a myriad of inclusions (Qatar, UAE and recently Saudi Arabia) has increased this representation to approximately 5.5%[2] now; with this portion set to grow even further with the addition of other inclusions, such as Kuwait starting 2020.

The MENA region has seen a consistent growth in the past few years where it achieved an average of 3% in the past five years in comparison to roughly 2% for developed markets. MENA countries have implemented several reforms to diversify their economies, as well as attract more foreign investments into their markets. A notable example is Saudi Arabia, which is undergoing a big privatisation programme under the umbrella of the Vision 2030. Furthermore, post-trade reforms are also underway in Kuwait, the UAE, Oman, Qatar, Bahrain, Egypt and as of recently, Saudi Arabia, which has generated the most client interest, on account of its deep liquidity pool and market capitalisation size.

In the long term, MENA is expected to represent up to 8% of MSCI EM index. This region is one of the most exciting stories in the emerging markets space; not only due to the significant growth it is set to witness at the macro level and the unutilised level of equities inventory (currently estimated at more than $100 billion[3]), but also because of the opportunities to build an efficient financial ecosystem that would allow the region to become more accessible for international investors.

The evolving market infrastructure's landscape in MENA

While the market has paid closer attention to the developments in Saudi Arabia, Qatar,

“In the long term, MENA is expected to represent up to 8% of MSCI EM index. This region is one of the most exciting stories in the emerging markets space.”

the UAE, Kuwait, and Egypt specifically, there is a commitment to improve market infrastructure across the entire region. Although the regional economies are competing with each other, the exchanges and regulators are highly motivated to raise capital and boost investors' interest in their respective local markets.

Before the inclusion of the MENA markets in the global emerging markets indices, local investors accounted for more than 90% of ownership and relatively few fund managers specialising in emerging markets had an interest in the region. The region is now experiencing the classic phenomenon of passive asset managers having to invest in the region in order to track their benchmark; and subsequently now accounting for the highest percentage of turnover.

The arrival of major index asset managers in any market brings an increase of intra-day liquidity, a demand in market making and a reduction of spreads; which effectively creates an environment where there is higher turnover, and a higher demand for leverage by market makers and asset managers.

Trading and execution are just one piece of the equities ecosystem; the latter also includes the ability to refinance, lend inventory and to short. Whilst the last three components are arguably still missing overall in the MENA landscape; the advent of international players in the local markets, jointly with the reforms implemented by local regulators will in time alleviate this issue.

HSBC - the partner of choice in the MENA region

Whilst London is undeniably one of the world's financial epicentres, MENA should also be considered through an on-the-ground lens. Local presence, expertise and proximity are crucial. At HSBC, we have been present in the region for more than six decades; with a significant presence in Egypt, UAE and Saudi Arabia.

We are using this proximity to work with regional regulators in their efforts to open up the local markets and facilitate the first repo and stock lending transactions. We have already done this in the fixed income space; where securities finance transactions are already taking place and where HSBC is a market leader.

With MENA's share of the emerging markets universe growing steadily it is very likely that the market will develop relatively quickly. Having an international broker, such as HSBC, facilitating clients' front-to-back access, is critical for institutional investors willing to gain exposure to the region.

HSBC services extensively cover the clients' journey of accessing the region: starting from algorithmic execution, getting synthetic access or index exposure, to applying for the QFII status, to being the main custodian, and to facilitating contacts with local regulators. ■

Sources: 1) MSCI; 2) MSCI; 3) HSBC.

“The region is now experiencing the classic phenomenon of passive asset managers having to invest in the region in order to track their benchmark; and subsequently now accounting for the highest percentage of turnover.”

Examining the case for sharia-compliant alternatives to repos

Matt Smith explores how sharia-compliant repo-like structures can support liquidity management in Islamic financial markets, and considers the structural, regulatory, and legal factors that need to be addressed to facilitate the further development and take-up of such instruments.

Islamic finance is steadily increasing its use of sharia-compliant alternatives to repos, helping the industry better manage liquidity and enabling sukuk holders to increase returns from their holdings.

Yet doubts over whether such structures are truly Islamic and a lack of standardisation has slowed take-up of these instruments, also posing fundamental questions as to whether the sector should be seeking to simply emulate conventional finance or trying to create a truly alternative approach.

"The starting premise is the same for most challenges in Islamic finance – that of trying to square a circle," says Khalid Howladar, managing director and founder of Dubai's Acreditus, a boutique risk, ratings, fintech and sukuk advisory practice.

Central banks use repos to control money supply, while commercial banks use them to manage short-term fluctuations in their cash holdings, and they are essential to the smooth functioning of financial markets.

In conventional finance, holders of government securities will sell such assets to investors, agreeing to repurchase them for a predetermined price, usually the following day with the asset itself used as collateral.

Such structures effectively involve paying interest and so are haram, or forbidden, under Islamic law, while the sale-and-buyback aspect of a repo is also unacceptable.

For the past decade, Bahrain's International Islamic Financial Market (IIFM) has been working with the Islamic finance industry to create a product that would be close to a conventional repo.

"Banks are trying replicate the economic aspect [of a repo] in a sharia-compliant manner, but the challenge is to ensure it is going to be legally recognised by a counterparty in the same way as a conventional one would be," says Howladar.

These difficulties have slowed the development of Islamic capital markets, especially as Islamic scholars differ on their interpretation of what is and is not allowed, while Basel III rules have made improving liquidity management a more pressing concern for Islamic banks.

"You need repos for cash and liquidity management, financing, structured products or more exotic investments such as derivatives and swaps, which are a complex, underdeveloped part of Islamic finance," says Bashar Al Natoor, global head of Islamic finance at Fitch Ratings. "It's an industry that's still trying to develop aspects that are essential to its operations."

He cites the example of having the ability to place excess liquidity at central banks, which until three to four years ago was not possible in many countries such as Saudi Arabia and the UAE. Now, these capabilities have helped banks better manage their cash.

"Some of the industry's essential components are still not in place – Islamic capital markets are not yet well developed," says Al Natoor.

"Each jurisdiction is moving at its own pace. As we see development in sharia capital markets and sukuk, the repo side will also develop. It won't happen in the short term, it's more of a medium-term development."

– Bashar Al Natoor, global head of Islamic finance at Fitch Ratings.

That many Islamic banks possess excess liquidity highlights "the importance of having alternative sharia-compliant liquidity management instruments," says Dr Bello Lawal Danbatta, secretary-general of the Islamic Financial Services Board (IFSB), a Malaysian standards-setting body.

"The development of Islamic repos would require a deep and developed Islamic money market where sharia-compliant securities are sufficiently available in various features including tenors, prices, liquidity characteristics," he says.

IFSB has issued various standards that attempt to address the challenges that Islamic banks face regarding liquidity management.

"Given the varying practices in Islamic banking, and diversity of sharia opinions on the subject, the IFSB has so far stopped short of offering a specific model for an Islamic repo mechanism, leaving that to individual jurisdictions and the approval of relevant sharia boards and the regulatory authorities," says Dr Danbatta.

Centralised sharia boards, especially in the Gulf, are not sufficiently developed to approve repo-like structures, notes Fitch's Al Natoor. "Once you have standardisation it will give banks more flexibility," he says.

"We're working with a number of banks to structure Islamic repos and reverse repos as well as alternatives to securities lending. The demand for such products is very encouraging – it's not a question of demand, but more of supply."

– Maya Marissa Malek, chief executive at Amanie Advisors.

There are two aspects to standardisation: the structure itself and the legal documentation.

"In terms of structure, the sharia principles are already available. In terms of legal documentation, I wouldn't say it's standardised, but it's harmonised to the extent that legal enforceability is intact," says Maya Marissa Malek, chief executive of Dubai's Amanie Advisors Ltd, a specialist Islamic finance advisory firm.

The UAE has launched a centralised sharia board, which has asked Islamic banks to comply with sharia standards from Bahrain's Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI), another standards-setting body.

Malaysia has several instruments available based on Wadiah – the safe custody of the depositor's funds – and Rahn, in which an asset is used as collateral in order to obtain debt, as well as sale-and-buyback facilities based on an underlying sukuk. Saudi Arabia has yet to introduce a centralised sharia board.

"Each jurisdiction is moving at its own pace," says Fitch's Al Natoor. "As we see development in sharia capital markets and sukuk, the repo side will also develop. It won't happen in the short term, it's more of a medium-term development. The industry is still growing in terms of liquidity – development of the more exotic instruments like repos and derivatives has been slower."

In 2014, IIFM created an alternative standard based on using collateral in order to remove the need for a binding sale-and-buyback agreement. Transaction volumes are not available, but several central banks including those of Malaysia, Bahrain and the United Arab Emirates have approved IIFM's Collateralized Murabaha Standard as a liquidity management tool. Financial institutions in several jurisdictions use it; Murabaha is a cost-plus-financing arrangement that is common in Islamic finance.

"This works well and enables the financial institutions to manage their liquidity and investment requirements by using sukuk or Islamic securities portfolio," says Ijlal Ahmed Alvi, IIFM chief executive.

"The Islamic finance industry mostly utilizes sukuk as collateral. Local regulations also come into play in shaping how quickly the collateral can be realised in case of default to fulfil the obligation under the agreement."

"Given the varying practices in Islamic banking, and diversity of sharia opinions on the subject, the IFSB has so far stopped short of offering a specific model for an Islamic repo mechanism, leaving that to individual jurisdictions and the approval of relevant sharia boards and the regulatory authorities."

Dr Bello Lawal Danbatta, secretary-general of the Islamic Financial Services Board (IFSB).

Yet such workarounds do not solve other problems relating to repos. Some jurisdictions lack sufficient sharia-compliant securities to use as collateral in an Islamic repo-like structure, notes Dr Danbatta.

Counterparties are also often sceptical as to whether the repo-like structures are truly Islamic, warns Amanie's Malek, while the risk that the terms differ depending on the specific instrument makes them significantly less liquid than conventional repos, says Acreditus' Howladar.

"We're trying to get both the economics of a repo, which is already a challenge, and then have it legally equivalent to conventional ones from a risk and regulatory standpoint," he says.

"Fundamentally, there are some things that can't be done in Islamic finance and perhaps some things that shouldn't be done. Islamic banks are already pretty profitable. Do they need to go further in replicating every single interest-based structure of conventional banking? I don't think it adds value."

A few banks – mostly the Islamic windows of conventional banks – offer sharia-compliant alternatives to repos.

"We're working with a number of banks to structure Islamic repos and reverse repos as well as alternatives to securities lending. The demand for such products is very encouraging – it's not a question of demand, but more of supply," says Amanie's Malek.

"As well as demand from the GCC, there's also a need for sharia-compliant liquidity in the UK and South East Asia because of the growing number of Islamic banks and Islamic windows – the demand for these products is always high."

In July 2018, Borsa Istanbul launched its Committed Transactions Market of Sukuk (CTM), which aims to enable trading of repo-like products that use sukuk – known in Turkey as lease certificates. Approved by

"In terms of structure, the sharia principles are already available. In terms of legal documentation, I wouldn't say it's standardised, but it's harmonised to the extent that legal enforceability is intact."

Maya Marissa Malek, chief executive of Dubai's Amanie Advisors Ltd.

Turkey's Islamic banking advisory board, CTM activity began in earnest in June 2019, when $25.9 million of contracts changed hands. July turnover ballooned to $892.1 million, while the first 15 days of August generated sales of $532 million, bourse data shows.

Enabling the widespread use of repo-like structures would also help expand the secondary sukuk market, which is typically dominated by buy-and-hold investors.

"Repos would allow banks to free up liquidity and stimulate the secondary market, allowing investors to purchase and re-sell on a collateralised basis," says Fitch's Al Natoor.

Yet asset growth among Islamic banks has slowed, while liquidity is increasingly scarce.

"Sharia alternatives to repos offer Islamic finance market players a way to monetise the sukuk they hold on their books," adds Malek. "It's a very useful way to get cheaper funding." ■

Opening up opportunities in MENA: From new markets to collateral expansion

Simon Heath, managing director – EMEA head of agency securities lending at J.P. Morgan, looks at recent developments in the MENA securities finance market and explains how agency lending is being adapted to meet clients' wider liquidity needs.

MENA is a strategically important region for the securities finance market and for J.P. Morgan in particular, with a large number of marquee clients who are active in the lending market and with increased activity in the region across a number of areas.

Within existing lending programmes, we have noticed a broadening of mandates through an increase in lendable assets, changes in collateral profiles as well as greater cash reinvestment opportunities. We have also experienced a more active dialogue – in terms of both the traditional agency lending model and broader agency financing capabilities – and an encouraging level of new enquiries from clients seeking not just securities lending but wider opportunities in financing and collateral.

> **"There are always a number of challenges to opening up a new market, but the work that has been done with the Saudi Stock Exchange and the initiatives undertaken by ISLA have been very helpful in this regard."**

Then there is the exciting prospect of new markets opening up. Developments in Saudi Arabia have been well documented and this will be a key market in the coming years, although it is not the only part of the region where securities finance has scope for expansion. If we look at Saudi Arabia specifically, the emergence of new lending markets is always a positive development for any region because it introduces greater liquidity, boosts the secondary market, and is helpful in terms of giving clients wider access to financing.

There are always a number of challenges to opening up a new market, but the work that has been done with the Saudi Stock Exchange and the initiatives undertaken by ISLA have been very helpful in this regard.

The challenges faced by MENA beneficial owners are similar to those faced by many clients in the current lending environment in that there is a degree of oversupply in the market vs demand. Given this, the

"Decisions around collateral are often pitched as a choice between cash and non-cash, but we have a rather more nuanced perspective in that we don't see them as binary options. A client can have a cash programme that is completely in line with their non-cash parameters."

responsibility of agent lenders is to come up with products to ensure local clients' assets remain active in programmes.

We have seen an increase in enquiries for the Saudi and Kuwaiti markets in terms of funding as well as borrowing, and this will lead to wider ownership of client assets and increased liquidity and financing opportunities within the secondary markets.

One of the questions that regularly arises during any discussion of the MENA securities finance market is whether we are seeing any changes in lenders' approaches to collateral. Over the last two years, there has been an expansion of the acceptable collateral in our lending programmes on an aggregate basis across a range of asset types, for example, Korean government debt. ETFs and broader equity schedules are also much more commonly accepted and I see no signs of this trend slowing down – in fact, collateral flexibility is increasingly a key differentiator for clients.

A key driver of this trend has been the large number of clients within the region who are at the forefront of expanding their collateral parameters, and this is a healthy sign for the market. Decisions around collateral are often pitched as a choice between cash and non-cash, but we have a rather more nuanced perspective in that we don't see them as binary options. A client can have a cash programme that is completely in line with their non-cash parameters. The risk profiles we are seeing between cash reinvestment programmes and non-cash are becoming increasingly harmonised. It then becomes a case of how we ensure that a client's programme has risk-adjusted returns and appropriate investment opportunities whilst ensuring we are trading on the client's assets in the most efficient and optimal way. Indemnification remains a key offering and, given we set aside capital for any collateral we take, the risk adjusted element is crucial for both client and agent.

In terms of how agents such as J.P. Morgan can support institutional investors in the region, agency lending is only one part of the broader agency financing capability. The pipes that facilitate the stock loan or agency financing can lend themselves to multiple uses and, when you take this view, you become part of a client's holistic collateral and investment strategy as well as their operational capability. This is a subtle but vital differentiator where agency lending can be adapted for a client's wider liquidity needs.

For clients, this is a much more strategic approach than saying 'I can make you x basis points on this portfolio'. Should a client wish to raise short-term liquidity, for example, the agency lending pipes can be used to structure these trades rather than selling assets or drawing down on other forms of liquidity. Such flexibility has obvious benefits across a client's business. ■

"In terms of how agents such as J.P. Morgan can support institutional investors in the region, agency lending is only one part of the broader agency financing capability."

Supporting investment excellence and market integrity in MENA

William Tohmé, CFA, regional head of the Middle East and North Africa at CFA Institute, explains how the institute's educational programmes, partnerships, and local presence are helping to advance skills and knowledge sharing in the region's investment management industry.

In 2018, CFA Institute opened an office in Abu Dhabi in collaboration with the Abu Dhabi Global Market (ADGM). Why did CFA Institute decide to establish a local presence in the Middle East?

The opening of our office in Abu Dhabi is an exciting milestone for CFA Institute and signifies commitment to the Middle East and North Africa (MENA). Establishing a permanent presence and serving the wider MENA region will enable us to support our candidates and members in local markets, and to honour our commitment to open up access in newer markets where there is demand for our portfolio of educational programmes. Through these, we hope to build on the work we are already doing with financial authorities, regulators, and employers to build a world-class investment profession.

Our collaboration with Abu Dhabi Global Market underscores the mutual commitment of both organisations to contribute to a growing international centre of excellence for knowledge in the Middle East; we intend to work together to explore new initiatives which strengthen the capabilities, proficiency and experience of financial professionals, including but not limited to the development of educational initiatives around the Global Investment Performance

> **"The collaboration between the two organisations underscores their mutual commitment to contribute to improve the levels of transparency and disclosure of Middle Eastern companies by facilitating a centre for knowledge exchange in the region."**

Standards (GIPS) and the Asset Manager Code (AMC); contributing insights into relevant regulatory frameworks to strengthen the financial system; exploring opportunities which could contribute to the ADGM Knowledge Hub Initiative; and a data centre related to financial sector information and intelligence.

How does CFA Institute support best practice among investment management professionals and promote transparency in the MENA region?

We do this primarily through our network of local member societies who work closely with CFA Program candidates, members, and charterholders. Our new office signals strong, lasting support for them, and we plan to intensify our efforts to build market integrity, enhance market transparency, and embed professionalism and excellence in the regional investment management industry in partnering ever more closely with them. The MENA region is important to CFA Institute, with over 5,200 members and a network of nine local member societies in the United Arab Emirates, Saudi Arabia, Bahrain, Kuwait, Lebanon, Doha, Egypt, Jordan, and Oman. In June this year, the greatest number of exam candidates for the CFA Program hailed from the United Arab Emirates (1,693), and candidate growth in Saudi Arabia was the highest across the MENA region, with 563 candidates, representing a 27% increase.

How do you see the work of CFA Institute in the Middle East contributing to the development of the local financial markets and their ability to attract foreign investment?

In this region, we try and do that in two distinct ways. First of all, it's developing human capital. We're providing a robust educational base in investment management skills, underpinned by ethical frameworks, for the bright, new individuals coming into the market. Secondly, and key, is that we're trying to develop market integrity, so that the market place in which individuals operate if they bring that sound judgement to bear, can benefit society in the way that we want it to happen.

CFA Institute recently signed a Memorandum of Understanding with the Middle East Investor Relations Association (MEIRA). What does this collaboration entail and what are its key aims?

The collaboration between the two organisations underscores their mutual commitment to contribute to improve the levels of transparency and disclosure of Middle Eastern companies by facilitating a centre for knowledge exchange in the region. Specifically, the MoU sets out a framework for collaboration between both entities to develop a network of knowledge sharing and best practice initiatives, in order to achieve better corporate governance objectives.

“Although several positive developments hint at an increased adoption of ESG integration practices by investors in the region, some challenges remain and will require the concurrence of different stakeholders to allow for a greater penetration of ESG in this market.”

In light of CFA Institute's work with the Principles for Responsible Investment (PRI) to better understand ESG integration practices globally, can you outline the extent to which investors in the Middle East are focusing on ESG and how you envision this trend evolving in the future?

ESG integration in the Arabian Gulf region is in its early stages. Although several positive developments hint at an increased adoption of ESG integration practices by investors in the region, some challenges remain and will require the concurrence of different stakeholders to allow for a greater penetration of ESG in this market. As in other regions, investors and companies are both still grappling with the concept of ESG integration, and the reporting of meaningful ESG data remains at an embryonic stage. Indeed, although pressing ESG issues have been identified for the entire region — notably water scarcity, climate change, governance reform, labor practices, and employment — the level of ESG uptake on the part of investors and regulators alike differs.

What are some of the main issues and priorities for your members and MENA-based investment professionals as we head into 2020?

The CFA Program curriculum provides valuable insight into fundamental changes as well as subtler shifts within the investment management industry. We engage in continual dialogue with practitioners and academics to inform considerations for changes within the curriculum, thus it is a useful bellwether of knowledge requirements for the industry. As we head into 2020, we have updated the curriculum to reflect progress in machine learning and Big Data, private wealth management, portfolio management of institutional investors, asset classes (ESG and alternatives to name a few), and ethics (fostering trust, professionalism, codes and standards, regulation). Of these topics, there is perhaps ever-increasing focus on ESG factors and fintech in the industry at large, and rightly so, they are the twin disruptors of our time, particularly among millennials who are tech-savvy, tech driven, and keen to invest with a conscience. We advocate for placing client interests at the heart of investment practice and a more purposeful kind of capitalism, thus our curriculum is also evolving to meet ever-growing ESG requirements. In summary, these changes should be helpful across a spectrum of roles and activities aside from the investment function.

Organisationally, we are increasing our focus and work on lifelong learning which is becoming more important to us and our members, that is, in pursuit of our mission to lead the investment profession globally. In terms of specific benefits for our members, one of our major areas of focus as we head into 2020 is to bring employers and our members together via our career centre, this will deliver huge benefits for our newly minted charterholders and existing members across the region. ■

“As we head into 2020, we have updated the curriculum to reflect progress in machine learning and Big Data, private wealth management, portfolio management of institutional investors, asset classes (ESG and alternatives to name a few), and ethics (fostering trust, professionalism, codes and standards, regulation).”

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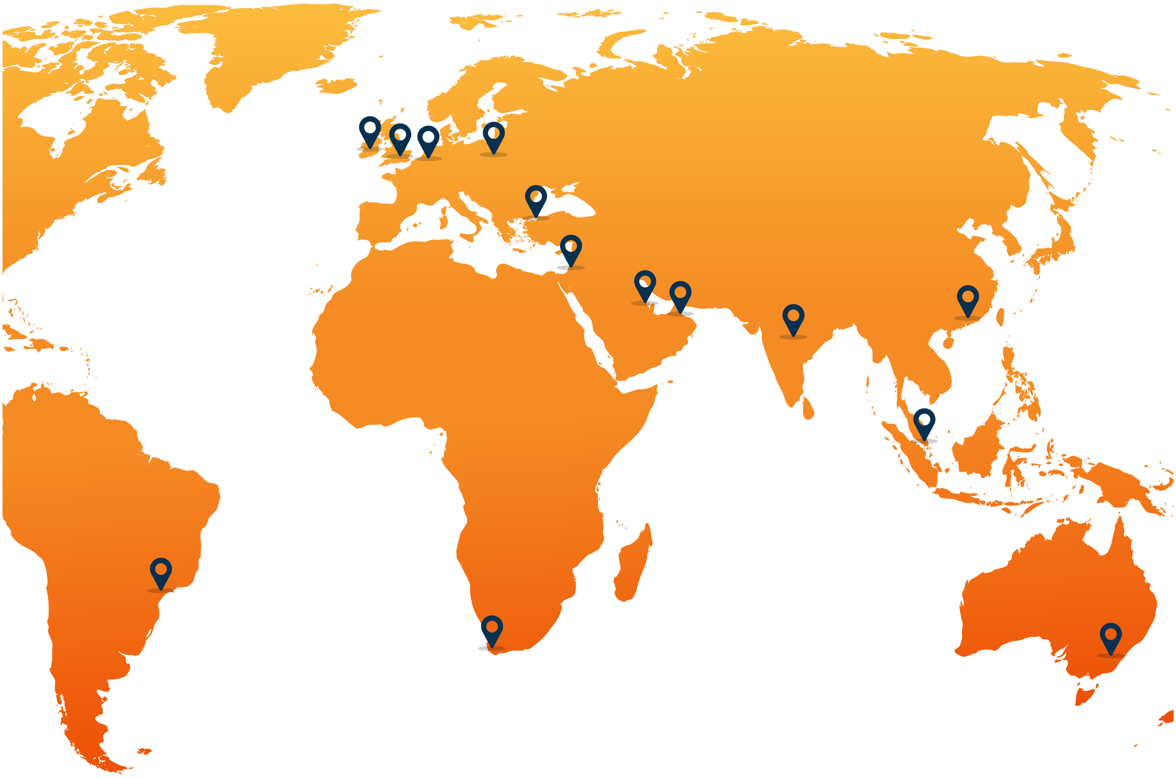

Events 2019

www.globalinvestorgroup.com

October 15	Trading CEE
November 6	Global Investor MENA Asset Management and Trading Summit
December 10	DW London and the International Awards Gala Dinner

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Five questions with... Emirates NBD Asset Management


Richard Lee and **Marwan Haddad,** senior portfolio managers at UAE-based Emirates NBD Asset Management, discuss the developments shaping the local market and provide their outlook for financial markets across the Middle East.

What have been the key geopolitical, economic, and regulatory factors influencing the UAE market over 2018-2019?

In fact, all these factors have continued to influence the market outlook for not just the UAE but the entire region, which is adapting to lower oil prices. Among these, the most difficult one to predict is geopolitics as past playbooks do not work and you can't model or position for it. In relation to regulatory factors, the government has certainly taken a number of steps to fine tune the economy by reducing fees and increasing incentives for businesses to attract more private sector investments. In terms of economic factors, both domestic and external drivers have underpinned the macro backdrop for UAE real estate and property sectors.

On the positive side, higher US interest rates boosted margins and thus profits for banks, offsetting the uninspiring loan growth due to a soft macro-economic environment. However, weak real estate market fundamentals negatively impacted asset prices of property developers. While we are aware of ongoing developments in the

"We highlight a global growth slowdown as a key imported risk as the economic environment in Europe remains weak alongside the ongoing trade war between the US and China, impacting Asian growth. In this backdrop, the downside risk to oil prices from their current level is significant particularly when higher US shale oil production is factored in."

region, our preference is on building client portfolios by taking a mix of a bottom-up and top-down approach, focusing extensively on company fundamentals. That being said, in Abu Dhabi, the bank consolidation theme gained momentum with the three-way merger of ADCB, UNB and Al Hilal after the successful merger between NBAD/FGB. Furthermore, First Abu Dhabi Bank set the precedent by increasing their foreign ownership limit from 25% to 40%, which led investors to speculate similar moves in other UAE-based names.

Looking ahead to the next 12 months, where do the main risks and opportunities lie?

We highlight a global growth slowdown as a key imported risk as the economic environment in Europe remains weak alongside the ongoing trade war between the US and China, impacting Asian growth. In this backdrop, the downside risk to oil prices from their current level is significant particularly when higher US shale oil production is factored in.

In the local market, the imbalance between demand and supply of real estate continues which could put further pressure on real estate asset prices and rents. The weaker economic environment with a downward trajectory in US rates can negatively impact banks' margins. Current valuations seem to indicate that some of these concerns are overdone and we expect a rebound in sentiment and economic activity as Expo 2020 draws near.

In the coming 12 months, investors have to be careful with stock picks/themes as there is likely to be significant divergence between winners and losers. We see specific opportunities in bank consolidation and in high quality companies within healthcare, logistics and real estate sectors that are likely to gain market share from smaller and weaker competitors, enabling them to increase cash flows and dividends. Furthermore, we see opportunities in fundamentally sound companies at reasonable valuation who could also benefit from an increase in foreign ownership limits (FOL). The UAE market trades at a significant discount to its peers; couple that with the potential FOL increase and country rotation from Saudi – the UAE market could see strong performance in 2020.

What is your outlook for financial markets in the MENA region over the longer term?

We do not think geopolitical issues and oil price volatility can ever be profitably predicted well ahead of time over the long term. Hence, investors will have to adjust the equity risk premiums accordingly. That being said, while these

> **"While risks remain, on a fundamental basis, we are constructive on MENA markets for the long term. Sovereign balance sheets are strong, currencies are pegged (for the most part) and government/regulators across the region have been very proactive in addressing key issues such as structural reforms, market transparency, liquidity, and foreign ownership levels."**

risks remain, on a fundamental basis, we are constructive on MENA markets for the long term. Sovereign balance sheets are strong, currencies are pegged (for the most part) and government/regulators across the region have been very proactive in addressing key issues such as structural reforms, market transparency, liquidity, and foreign ownership levels. We do foresee these developments having a meaningful impact on the economies/markets and consequently, the MENA region shall play a more prominent role for investors in the broader emerging market basket. Having said that, reform programs are likely to lead to structural shifts creating winners and losers within different industries. Our top-down and bottom-up approach of identifying how individual sectors and companies are positioned shall enable us to capitalize on sector or stock-specific stories that are likely to generate returns in the 12-18 month horizon.

As more countries in the Middle East look to facilitate securities lending and borrowing activities, what impact could this have on regional markets and asset managers' engagement with securities finance?

The Saudi market had seen more securities lending and borrowing activities after the first tranche of the Saudi MSCI inclusion in May and that number is expected to accelerate by the end of August, when the second tranche takes place. Given a small free float, a somewhat limited foreign ownership, against a backdrop of large government ownerships and participation in MENA markets, however, we do not expect to see a lot of inventory available for lending. The passive investors, most probably, will be the main providers. Given these factors and along with an increased volatility in emerging market inflows, shorting will be even more risky. An example in the region – Qatar – we have seen many investors trying to short the Qatari market in 2018, which did not end very well for many of them. Nevertheless, it is expected that securities lending and borrowing shall improve market liquidity and price discovery in the MENA markets.

What does 2020 have in store for Emirates NBD Asset Management?

At Emirates NBD Asset Management, we follow a disciplined investment approach focusing on value and alpha creation. Built on the success of our MENA equity franchise, we are excited to add new geographies to our investment universe. The focus will always be on emerging/frontier countries where market inefficiencies are high. Given the heavy concentration of oil exporters within the MENA region, we will start with large diversified economies who are mostly oil importers, hence, offering a wider product range to our clients. Markets such as Turkey, South Africa and Russia rank highly on our value screeners, today. ■

“Our top-down and bottom-up approach of identifying how individual sectors and companies are positioned shall enable us to capitalize on sector or stock-specific stories that are likely to generate returns in the 12-18 month horizon.”

Bahrain

The Central Bank of Bahrain (CBB) formally introduced short selling and securities lending into the Kingdom's capital markets ecosystem earlier in 2019 after issuing new rules.

Resolution No. (23) of 2019 in respect of short selling and securities on loan was published in the Official Gazette No. (3411) on March 23.

CBB Law states the following: "The Central Bank shall specify the types of securities, which may be traded by loan and short sale, the terms and procedures of such transactions and the rights and obligations of all concerned parties."

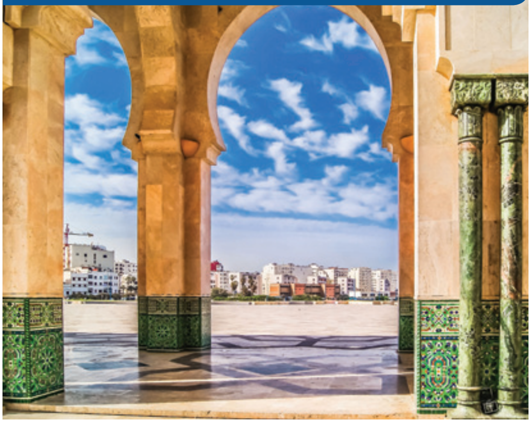
The CBB said it continuously aims to "remain abreast" of market changes, diversify its product offerings and proactively adopt initiatives and projects that cater to market participants within the capital markets in the Kingdom.

Moreover, the CBB added: "The objective of the Resolution is to improve the efficiency of the capital markets in the Kingdom by promoting new investment and trading strategies through diversification of investment instruments which shall result in better price discovery, enhanced liquidity and attracting new sophisticated investors."

The rules come with controls and procedures pertaining to lending, borrowing and short selling of eligible securities, the obligations of the related parties, and make reference to necessary guidelines and instructions.

- In Bahrain, the CSDR (Clearing, Settlement Depository and Registry) is responsible for organizing the activities of lending and borrowing of securities and all such activities must be made through or be facilitated by the CSDR. The CSDR (i.e. the Clearing, Settlement and Central Depository and Registry) must be licensed by the CBB to provide clearing, settlement, depository and central registry services for securities.
- The licensed exchange is responsible for organizing the activities of short selling. The exchange must be a market licensed by the CBB through which securities can be traded according to the provisions of the CBB Law.
- Lending and borrowing agents, who are legal persons authorized by the CSDR, to perform securities lending and borrowing in accordance with the provisions of the respective regulation, must be licensed by the CBB as a bank, an investment business firm (Category-1) or a CSDR, subject to prior approval of the CBB. The CSDR will issue instructions related to the registration and authorization of the lending and borrowing agents. ■

Morocco



Legal changes concerning the introduction of securities lending on the Moroccan stock market remain in the legislative circuit, where they have been since early 2018.

Eventually, adjustments are expected to boost the volumes exchanged and enhance liquidity in several compartments on the Casablanca Stock Exchange.

Morocco was downgraded in 2013 from emerging to frontier market status. Ratings agency (MSCI) explained at the time that this was mainly due to the lack of liquidity.

Since then, Moroccan authorities and market makers agreed on a list of measures (including stock lending and short selling) designed to boost activity, including a complete IT infrastructure overhaul by adopting MillenniumIT solutions.

MillenniumIT is wholly owned by London Stock Exchange Group.

"The Moroccan market structure is particularly affected by a weak free-floating currency and immobile capital," explained Badr Eddine Sadouk, head of sales and relationship manager at BMCI Securities Services.

He continued: "The securities lending mechanism is a pre-requisite to short-selling authorisation on our market and allows institutional investors to re-inject a portion of their holdings in the stock market.

"A long-term investor (lender) would be authorized to transfer temporarily a part of its non-used holdings to a short-term investor (borrower) for a period of time contractually agreed on between parties.

"As a consequence, this mechanism motivates institutional long-term share-holders to diversify their sources of income thanks to their 'sleeping holdings'. Decreasing stock values benefit the borrowers, UCITS are more attractive to individuals, custodians and CSDs while account holders increase their revenues, creating a virtuous economic circle."

According to Sadouk, securities lending is one part of an ambitious and global strategic plan for the Moroccan stock market (as well as derivatives, ETFs) and its legal framework must take into account soon-to-be-introduced financial instruments and mechanisms.

Also, consideration needs to be given to the creation of a calculation agent for lending-borrowing margin calls.

"As a consequence, the legal text is still under discussion with the Moroccan Ministry of Finance and Economy," Sadouk added. "Then will come the validation by the General Secretariat of the Government and the Parliament."

The final text is not expected theoretically before 2020 at the earliest given its complexity. ■

Israel

The Tel-Aviv Stock Exchange (TASE) is the primary venue for the trading, listing and clearing of securities in Israel.

In addition to being a beneficiary of higher volatility and trading in its markets, the TASE has also recently launched several new products and services which should drive both higher recurring revenues and increase trading velocity over time.

For example, a blockchain-powered centralized lending pool which is expected to go live in 2020 should improve liquidity and reduce costs in the securities lending market.

Longer term, improved market liquidity should be a key selling point to attracting new listings as well as additional foreign capital into the market.

The exodus of Israeli-based companies to other global exchanges has been a consistent trend in recent years.

"With the improvements in technology (i.e. co-location, etc.) as well as the increased brand awareness effort and economic incentives that the TASE is providing, the value proposition for companies to "stay home" has improved dramatically," Dan Fannon, analyst at Jefferies, wrote in a note to clients at the start of September.

"We believe the most immediate opportunity is to attract Israel-based companies that are currently listed on the LSE or Nasdaq to dual list on the TASE."

TASE has identified 100+ Israeli companies that are currently listed abroad with an aggregate market cap > ILS 300 billion (£70 billion) which they are actively pitching.

"The benefits from an increased number of listed companies are multi-faceted," Fannon added. "The increase in listings fees is immediate, but ultimately increasing the number of shares listed on the TASE will drive higher trading volume and potentially drive higher demand for exchange data over time."

In terms of product development, the company rolled out its volatility index (VTA-35) which reflects volatility on the TA-35 Index.

Lastly, the company has welcomed several of BlackRock's directly listed ETFs onto the TASE.

On the domestic front, the exchange is targeting greater retail participation through partnerships with retail brokers and increased access through mobile applications and a greater focus on individual investors. ■

Egypt

The Egyptian Exchange, EGX, plans to introduce short selling by December in a bid to boost liquidity in its home market.

Speaking to reporters in London at the start of September, EGX chairman Mohamed Farid described the offering as a "complete securities borrowing and lending mechanism associated or coupled with short selling."

"All technological requirements have been fulfilled and 25 to 30 brokers are registered to operate shorting," Bloomberg quoted Farid as saying.

By allowing short selling the exchange should generate more trading and better price discovery for stocks.

The Egyptian government has plans to list or sell additional stakes in more than 20 state-run companies this year, part of a broader programme to overhaul the country's economy.

Farid told Bloomberg that at least three companies that had planned initial public offerings by December 2019 had decided to delay them to 2020.

A new system named CRM "client relation management" has been launched in order to identify companies from various economic sectors that are eligible to list on EGX, as well as inform them of its advantages.

EGX management has so far been able to contact more than 150 companies via the system.

In August, EGX signed an agreement with the Ministry of Public Business Sector of Egypt around investor relations.

Farid stated that the partnership would strengthen the level of communication between listed companies and shareholders, improving the quality of disclosure of listed companies, as well as governance standards of public sector companies. ■

Kuwait

Index compiler MSCI plans to upgrade Kuwaiti equities to its flagship emerging market index amid ongoing work in the country to introduce central clearing, short selling and securities lending.

On June 25, the New York-based firm announced plans to reclassify the MSCI Kuwait Index from frontier to emerging in May 2020, providing certain enhancements are made around account structures and unique investor identification numbers.

Investment bank EFG Hermes said the move could attract $2.8 billion of inflows from passive funds.

MSCI's emerging market group of indexes has about $1.8 trillion of assets tied to it.

Kuwait will be the fourth country from the Middle East to be upgraded after the UAE, Qatar and Saudi Arabia were awarded the title.

A year ago Kuwait was upgraded by FTSE Russell into its emerging markets gauge.

"Enhancements have significantly increased the accessibility level of the Kuwaiti equity market for international institutional investors and resulted in broad positive feedback from these investors on our reclassification proposal," said Sebastien Lieblich, global head of equity solutions and chairman of the MSCI Equity Index Committee.

Kuwait's market development project, which began in 2017, has opened the domestic equity market to international institutional investors.

Among these enhancements were the removal of foreign ownership restrictions on listed banks and simplification of requirements for investor registration.

In addition, the settlement cycle in the Kuwaiti equity market moved to T+3 for both local and foreign investors, a new delivery versus payment (DvP) settlement provision was introduced and a proper failed trade management process was initiated.

The project is expected to continue with the planned introduction of a central clearing counterparty and availability of stock swaps, stock lending and short selling facilities, among other improvements. ■

"Enhancements have significantly increased the accessibility level of the Kuwaiti equity market for international institutional investors and resulted in broad positive feedback from these investors on our reclassification proposal."

Sebastien Lieblich, MSCI Equity Index Committee.

Qatar

Since four of Qatar's neighbours hit it with an economic and diplomatic embargo back in June 2017, Qatar has been working to attract new sources of foreign capital to its domestic market.

Changes to foreign ownership limits for a number of Qatari-listed companies have led to an increase in foreign capital inflows.

As a result, the Qatar Stock Exchange (QSE) has seen changes in trading patterns, with foreign institutions being far more active in the market than previously.

The exchange is also working to bring more high-quality companies to the market with the objective of increasing both the breadth and depth of its market and potentially bringing further foreign capital inflows.

On that front, the bourse is working with the local regulator to try and ease the burdens associated with listing.

At the outset of 2019 there were some 46 companies listed on the QSE.

Meanwhile, QSE is working on expanding its service offering to better meet the needs of investors.

In an April interview with Oxford Business Group, Rashid bin Ali Al Mansoori, QSE's chief executive, commented: "We hope to introduce securities lending and borrowing and covered short selling, but will also look to increase the number of exchange-traded funds and introduce other fund-based products, such as real estate investment funds. All these initiatives are designed to attract foreign investors."

The Qatar Central Securities Depository (QCSD) is licensed by Qatar Financial Market Authority (QFMA) to provide safekeeping, clearing and settlement of securities and other financial instruments listed on the QSE.

The company is currently undertaking several projects to develop its infrastructure. The most important of these projects is replacing the existing post-trade clearing and settlement system. ■

Tadawul's vision takes shape

Global Investor spoke to **Khalid Al Hussan,** chief executive officer at the Saudi Stock Exchange (Tadawul), about the latest market enhancements and planned developments.

How has the MSCI upgrade to emerging market status impacted Tadawul and changed perceptions of Saudi Arabia as a market?

The MSCI upgrade to emerging market status, as well as the inclusion into the FTSE Russell and S&P Emerging Market indices, has accelerated the participation of international investors to the Saudi stock market. The reforms and market enhancements implemented over the past two years have aligned Tadawul with international best practices, which has been recognised by the inclusion into these key global indices. Between the decision to open up the Saudi market to international investors in February 2015, through to the day before the announcement of inclusion in May 2018, 130 Qualified Foreign Investors (QFIs) were registered to be able invest and trade directly in Saudi equities. As of the end of July, and in the space of only 13 months, this increased to over 1,305. The increasing participation of QFIs has also assisted the Saudi stock market index (Tadawul All Share Index or TASI) deliver 8% growth in 2018, compared to a more than a 16% drop in the MSCI Emerging Markets Index. The TASI has risen by 13% in 2019, also outperforming most other global markets. Supporting this dynamic outperformance of other markets, foreign investors were net buyers of more than SAR51 billion of Saudi shares from January up to the end of April 2019. The further implementation of the remaining index inclusion tranches is expected to further accelerate inflows.

The performance of the TASI and the increasing volume of QFI participation fully underpin a significant change in perception towards the Saudi market over the past few years.

Why was it important to establish a CCP? Is the CCP now fully operational? What more needs to be done?

Tadawul's strategic plan is designed to create an exchange with world-class turnkey solutions. The Securities Clearing Center Company's (Muqassa) role as an independent clearinghouse directly enables the achievement of that strategy by strengthening the market's

"The reforms and market enhancements implemented over the past two years have aligned Tadawul with international best practices."

post-trade infrastructure, provides centralised counterparty risk management in accordance with international risk management practices, and enables the introduction of new products and services, such as the derivatives market.

Muqassa will be operational in the market once all required regulatory approvals are complete, which is expected in the second half of 2019.

Muqassa also anticipates a three-phase market activation:

- Phase 1 will cover index future contracts clearing, anticipated in 2019.
- Phase 2 will cover equities, sukuk, bonds, ETFs and REITs markets clearing, anticipated in 2020.
- Phase 3 will cover the full derivatives market clearing, anticipated in 2021.

We are working closely with The Capital Market Authority (CMA), Saudi Arabian Monetary Authority (SAMA), and market participants in order to activate Muqassa in the market successfully this year.

Can you outline the latest developments of securities lending/short selling? What benefits does securities lending bring to the market? Was there any market resistance/scepticism to the introduction of securities lending?

The introduction of securities borrowing and lending, and covered short selling, coincided with the establishment of the Securities Clearing Centre Company (Muqassa), T+2 settlement, the spin-off of the Securities Depository Center Company (Edaa), amongst a range of other market enhancements. The security lending enhancements have been implemented in accordance with international best practice and risk management standards. The addition of these enhancements allows investors to use hedging strategies to mitigate risk when investing in the Saudi capital market. This has helped accelerate the attraction of our markets to QFIs.

In view of the substantial reforms and enhancements implemented over the past two years, including securities borrowing and lending, a broad range of emerging market stakeholders, including market participants, investors and QFIs, have welcomed the changes as they were directly engaged in considerable consultation with Tadawul for these developments over the past few years.

What are the plans/timelines for the introductions of derivatives?

Introducing derivatives trading is one of the initiatives under the Vision 2030 Financial Sector Development Program, further advancing Saudi Arabia's capital market. Tadawul intends to launch exchange-traded derivatives that would be centrally cleared through Muqassa before the end of 2019.

The first exchange traded derivatives product, in preparation for the broader derivatives platform, will be the index futures contract with the underlying being the MT30 index (to be launched in the second half of 2019). Additional products shall be launched subject to market demand, including index options, single stock futures and options.

What other market enhancements are being made by Tadawul as we approach 2020?

Recent enhancements to the sukuk and bonds markets represent an important step in developing the Kingdom's public debt market by encouraging issuers to list more Saudi currency sukuk and bonds and facilitating increased trading by investors, which will result in increased market liquidity. Increased liquidity in the public debt market will, in turn, contribute to the issuance of more diversified debt instruments and introduction of new asset classes for investors. On April 25 2019, Tadawul, along with CMA and the Debt Management Office (DMO) unveiled a number of enhancements to the fee and commission structure of the sukuk and bonds market. The changes were only recently implemented in the last few weeks.

In the first quarter of this year, Tadawul also unveiled a series of structural changes to Nomu – the Parallel Market aimed at supporting the growth, development and sustainability of the SME-focused market, increasing the number of listed companies on Nomu and enhancing market liquidity.

More recently, we implemented a daily "Trade at Last" session immediately following the closing auction as an additional 10-minute session during which orders can be placed and matched at the closing price.

What important steps are being taken to market entry and investment for QFIs?

Beyond committing to the enhancements and developments that we have already discussed above, we will support market entry and investment for international investors through continuing to align Tadawul to international best practices and taking the necessary measures to advance Saudi Arabia's capital market.

> **"We will continue to focus on sustainability, ESG reporting and transparency."**

To this end, we will continue to focus on sustainability, ESG reporting and transparency as they are very important to the investor community and have made a significant difference in Tadawul's perception and participation. For example, Saudi Arabia's global shareholder governance rank jumped from 77th in 2017 to fifth overall, and second among G20 economies in 2018 (World Economic Forum's Global Competitive Report, 2018).

More broadly, capital market reforms – particularly those aimed at encouraging international investors' participation in the Saudi capital market – have been a linchpin in unlocking the Kingdom's economic and investment potential. Far-ranging reforms undertaken by Tadawul in conjunction with the Capital Market Authority over the past two years have improved market function and efficiency, expanded access, enhanced corporate governance, and increased transparency, further aligning the Saudi capital market with international standards and making it more attractive to international investors.

As we strive to achieve our goals of becoming an active player in the global capital markets and an investment destination, we will continue to make the necessary steps to offer investors a full and diversified range of products and services. ■

United Arab Emirates

It has been almost two years since Dubai Financial Market (DFM) introduced regulated short selling (RSS) to enhance liquidity in the market. The RSS service runs alongside previously implemented securities lending and borrowing capabilities.

In January 2018, DFM announced its first list of securities eligible for trading under the RSS service. To prepare for the introduction of the service, DFM, consulted with market participants, carried out technical enhancements to ready its systems and regulations, and conducted an awareness raising campaign.

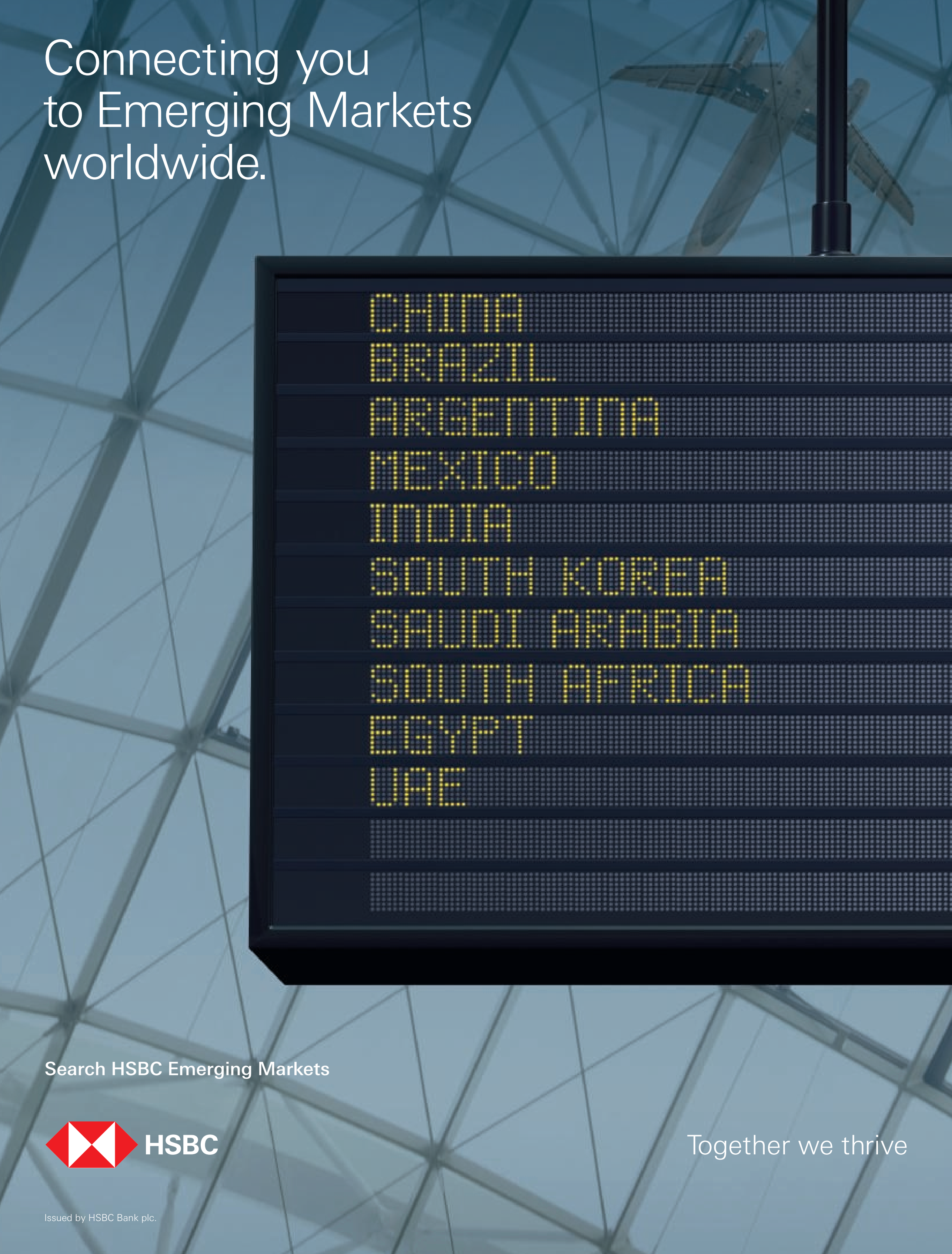
The Abu Dhabi Securities Exchange (ADX) launched its Technical Short Selling (TSS) service back in October 2017 as part of its strategy to attract more foreign investors by improving liquidity and diversifying investment and hedging instruments.

Economy

Economic growth in the United Arab Emirates (UAE) is projected to continue to strengthen after recovering to 1.6% in 2018. The latest economic update from the World Bank, published in April 2019, forecasts growth of 3.2% by 2021 driven by the government's economic stimulus plans, momentum from hosting Expo 2020 in Dubai, and improved growth prospects in trading partners.

This expectation for growth has been echoed by the International Monetary Fund (IMF). Upon the conclusion of the IMF's mission to the UAE in April-May 2019, Koshy Mathai, IMF advisor and leader of the mission, said: "The economy may now be at a turning point, supported by public spending - a substantial amount of Expo 2020 investment should be completed by end-year, some government-related entities (GREs) are embarking on new investment plans, and implementation of emirate-level stimulus is expected to accelerate - as well as by external tailwinds (higher oil prices and the pause in Fed tightening). Against this background, growth could exceed 2% this year and approach 3% in 2020-21.

"The UAE economy has gone a long way toward diversification, but government spending and some sectors are still affected by oil price fluctuations. Sustaining strong growth after Expo 2020 and the fiscal stimulus will require capitalizing on new growth drivers that are decoupled from oil prices, and this in turn will require the authorities to build on their ongoing structural reform momentum." ■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