



Time to work on weaknesses

As volumes drop in the UAE's securities markets and investor sentiments dive to new lows, it is time for all stakeholders to refocus and come up with solutions to improve the investing environment.

Ritwika Chaudhuri reports.

The best times to review, re-evaluate and re-think are when chips are down. Now more than ever, all stakeholders in the UAE's securities markets need to analyse what needs to be done to increase and sustain depth in these markets.

In recent years, these markets have seen an increase in institutional participation, but they have also been besieged by hot money that vanished as quickly as it came, leading to widespread losses. Local institutions and retail investors that have been the backbone of stock trading in the region suffered the brunt of it.

Experts say the securities markets in the country have progressed impressively within a short span of time and that it is unfair to compare their pace of development with that of stock exchanges in London, New York, India, Tokyo and Hong Kong that are centuries old and have

gone through phases of development to reach their present levels.

"There is nothing to be ashamed of regarding the pace and stage of the development of the UAE's securities markets," says Arindam Das, regional head of custody and deputy head of HSBC securities services for the Middle East and North Africa at HSBC Bank Middle East.

Das adds: "In terms of regulations, fundamentals and infrastructure, there have

been significant developments in these markets in the past few years. It would be naïve to compare these markets with developed markets, as it is not possible to start at the same level from day one."

Although a lot of effort has undoubtedly gone into creating regulations and trading platforms that are on par with global peers, these efforts have not been enough to bring depth or breadth to the local market. There is also a shortage of investment

DFM at a glance

Growth in	2004	2005	2006	2007	Q1 2008
The DFM general index	172%	131%	-44%	44%	-9.7%
Market capitalisation US\$ billions	38	112	88	139	141
Total market value	1,177%	694%	-14%	6%	26.19%
Number of shares traded	1,470%	342%	75%	158%	27.36%
Number of new companies listed	29	46	52	56	59

Source: MAC Research

products and number of stocks listed, while too many brokers chase too few goods.

There are 59 companies listed on the Dubai Financial Market (DFM) and 65 listed on the Abu Dhabi Securities Exchange (ADX), while the total number of member brokers is 101. NASDAQ Dubai has 240 members, while the Dubai Mercantile Exchange (DME) has another 70 members.

Multiple regulators also create confusion, according to participants. They say that combined with multiple regulatory norms and procedural complexities, lack of transparency in the information available on listed companies, low level of foreign participation, poor communication from the regulators and lack of investor awareness all create a potent mixture that bodes ill health.

The current global and local environment is accentuating these weaknesses in the local markets, and investors today are a wary lot.

“Overall, there is huge reticence towards investment,” observes Colm O’Donnell, compliance officer of National Bank of Abu Dhabi’s asset management group.

Existing exchanges

The DFM, ADX and the Dubai Gold and Commodities Exchange are regulated by the Emirates Securities and Commodities Authority (ESCA), while NASDAQ Dubai and the DME are regulated by the Dubai Financial Services Authority.

Some question the logic behind so many exchanges, even when there are clear overlaps. Nevertheless, most experts feel that since the exchanges are already in operation, the solution lies in concentrating on the area of specialisation while ensuring more listing, more volume and, at the same time, trying to attract more investors, both retail and institutional, to make the markets vibrant. It is also important to ensure the consolidation of offerings from the different exchanges, experts add.

“Because all these exchanges have been already started, it will make sense to carry on improving their businesses. It may also be a good idea to look at merging complementary businesses,” says Dhaheer Quraish, an expert on the UAE securities market.

Khaled W. Kurdieh, CEO of Mashreq

Securities, has a slightly different point of view. He says: “One or more exchanges is not an issue, as investors in some of the international markets, unlike the UAE and other regional exchanges, are not required to have a direct relationship with each exchange through a unique investor ID. We can certainly simplify the operational process and eliminate redundancies for both clients and the brokers through basic consolidation.”

Regulatory issues

Kurdieh also has reservations about the number of regulators in the country. He feels that it is not easy to have two regulators to work with, given the size of the UAE markets. Some alignment in regulations of similar products could definitely make things easier, he adds.

The other important issue is the effectiveness of the regulatory mechanism. Needless to say, while a liberal, efficient, investor-friendly and open regulatory mechanism can work wonders to help develop a securities market, stringent guidelines can be equally counterproductive.

So, are the regulators on the right track? Most market participants say yes, although they admit that a few areas need to be improved.

Kurdieh lauds the efforts put forth by the country’s regulatory authorities. “Both ESCA and the DFSA have put in tremendous efforts to create a robust regulatory framework. We expect enactment of more rules based on best practices in the future, as these markets list new investment products,” he says.

Sajith Kumar, vice president of JRG Metals & Commodities DMCC, agrees. He also points to ESCA’s efforts to educate investors in the region about derivatives and futures products.



Arindam Das

In its efforts to beef up the regulatory framework, ESCA made a strategic plan last year covering the period up to the end of 2010. The plan includes amendments and adjustments of some of the existing regulations and provisions for the introduction of new ones to facilitate a better investment and trading environment.

These adjustments include regulations on margin trading, financial consultations and financial analysis and joint listing in the financial markets. ESCA has also introduced a number of legislative amendments to the existing regulations in the areas dealing with mediators, disclosure and transparency norms, regulations related to trading and clearing procedures, transfer of ownership and conservation of securities, Islamic bonds and the inclusion of debt bonds, fees owed to the board and arbitration.

The ESCA board has mandated mediation companies to separate customers’ accounts from its own. With regard to information technology, the authority has accomplished a number of projects that were aimed at improving the internal electronic environment.

ESCA is also working on giving better

ADSM at a glance

Growth in	2004	2005	2006	2007	Q1 2008
The ADX general index	75%	69%	-42%	51%	0.1%
Market capitalisation US\$ billions	56	139	81	124	122
Total market value	34.3%	54.1%	-33%	148%	113.83%
Number of shares traded	303%	773%	37%	361%	109.54%
Number of new companies listed	35	59	60	64	64

Source: MAC Research



Dhaheer Quraish

accessibility to foreign participants, treating GCC nationals as national shareholders rather than foreign shareholders, expanding the foreign investment limit and including the UAE market in key emerging market benchmarks such as the MSCI EM Index.

“These are all important elements towards moving into a more open market climate. If we want to take part in the new era of globalisation in good times and bad, we must take the necessary measures towards it. Perhaps this is where regulators need to choose the right time for each initiative and lay down solid foundations in order to minimise the damage from an adverse financial event,” Kurdieh notes.

Yet, several issues have disappointed the broking community. Capital requirement is one of the prime disappointments, brokers say. In the period from 2005 to 2007, authorities allowed the liberal entry of a number of brokers and then subsequently started increasing the minimum capital requirements from AED5 million to AED30 million.

“One must keep in mind that it is not a good practice in general to tighten norms when the going is great and let loose when market conditions are bad, as it might be too late for those regulations to work,” Quraish argues.

Quraish further adds that, at least in the context of the current financial and economic crisis, the authorities have not been able to take adequate measures to keep markets like the DFM or ADX from freefall.

“Given the fact that the present condition started in September 2008, if the regulators had taken some drastic and intelligent decisions, billions of dollars in losses could have been avoided. Fine tuning the circuit breakers at the exchanges might not have resulted in such big falls in the indexes,” he points out.

Investor awareness

Inadequate investor knowledge in terms of available products is also a cause of concern for the market, in addition to the restriction on foreign participation. But, above all, communications from the regulators to the different players in the market make a difference.

“It is also time to address areas like introducing codes of business ethics and introducing a cell for investor grievances and consumer complaints,” suggests O’Donnell.

Kurdieh adds: “Challenges are interrelated. Dominance of the retail segment, percentage of foreign ownership allowed and the lack of market depth and breadth are some of the challenges faced by the UAE securities market.”

Quraish also points to the lack of

diversity in investment products and urges an improvement in market data and analysis for the benefit of investors. The liquidity lifeline also needs to be improved with finance from the banks, he adds.

Kumar notes: “It is time to introduce equity derivatives, short selling and margin trading in ADX and the DFM to give more options to investors. Also, these will eventually lead to more volume and liquidity in the market.”

Margin trading is on ESCA’s list, while ADX is seriously considering the introduction of exchange-traded funds (ETFs). NASDAQ Dubai has already introduced equity derivatives. But opinions regarding the introduction of new products are varied, as many question whether the markets are ready to handle these sophisticated products.

Quraish and Kurdieh are in favour of ETFs, due to their tremendous success in the US market. They are, however, not convinced about other products and say they need to be introduced with caution.

“Products like futures and options, equity derivatives, short selling and margin trading form the financial tools that are necessary for professional investors to maximise their returns. At the same time, some products can help minimise risk,” Kurdieh says. “Banks already offer leverage based on UAE central bank guidelines. Brokers might soon be able to offer margin lending to their clients as per ESCA guidelines.”

Kurdieh points out that some derivative products are already traded on NASDAQ



Sajith Kumar

Market capitalisation – GCC equity markets

Major MENA markets	Market capitalisation (US\$ bn)					Change from Dec 2008
	2005	2006	2007	2008	2009**	
Saudi Arabia	646	327	519	247	239	-3.1%
Kuwait	142	144	211	121	99	-18.7%
Qatar	87	61	93	77	61	-21.1%
Oman	13	13	23	15	14	-8.7%
UAE*	231	169	257	132	127	-3.8%
Bahrain	17	21	27	20	19	-5.0%

Source: Bloomberg, Zawya & Global Research. *DFM & ADX ** As of January 19, 2009



Khaled W. Kurdieh

Dubai. But short selling, despite its principal objective to capitalise on market downturns or troubled companies, requires a market with much more depth and a greater institutional client base in order to be an effective investment tool, he adds.

There are other problems as well, as dominance by retail investors makes it difficult to control volatility. An increase in institutional market share can certainly create the right balance, but in order for institutional investors to become dominant, they demand sophisticated products and credible brokers.

Along with the introduction of products, it is important to create awareness and educate investors about the products and ensure their participation.

"NASDAQ Dubai has introduced equity derivatives, but there is no liquidity, no volume, due to low participation," a senior official of a broking firm points out. "The key to success, hence, is

more regional participation and investor education."

Foreign participation

Another issue that needs to be addressed is post-trading settlements. Das says that the difference between delivery and payment needs to be as close as possible. While this concept is better practiced in NASDAQ Dubai, the same is not true with the DFM or ADX. The areas of operation of custodians are not very clearly defined, which is a deterrent to international institutional investing, Das adds.

Das points out that the market here started with retail investors, while local and international institutions came later. Although issues with retail investors can be solved only with brokers, the role of custodians becomes very important at the institutional level.

The other major area of concern is international participation – companies as well as foreign institutional investors (FI). Not all stocks are open to foreign participation (it depends on the company concerned), with a maximum limit of 49 per cent.

Even at the height of the market boom (starting late 2007 to mid-2008), only 25 per cent of transactions were from FIs, while the remaining 75 per cent came from local investors. One of the primary reasons for less participation by FIs is the lack of depth and breadth of investment options, Das explains. There are also a fewer number of listed stocks in the country's regional markets compared to market capitalisation.

"We need liquidity, transparency,

Challenges: UAE securities market

- Proactive measures from the regulators, rather than reactive measures
- Too many regulators; needs some alignment in terms of regulation for the ease of the investors
- Investment products need to offer diversity along with depth and breadth of investment options
- More transparent information on the listed companies
- Improved market data and analysis
- Market depth and breadth needs to be widened
- Foreign ownership allowances and participation
- Investor awareness and education
- Underdeveloped post-trading settlement
- Markets not attached to any benchmark index

product depth and maturity to deal with large international players. The entire financial and investment eco-system needs to be improved in this region," Quraish says.

One of the ways to improve the system, according to Quraish, is to encourage the listing of more companies in the exchanges by relaxing listing regulations and developing index-based stocks.

The risk-return trade-off is also being carefully considered by FIs, especially after the market crash in recent months. FIs have become even more cautious today, as the Gulf economy has shown how coupled it is with the global economy, leading to speculative money drying up.

"We need to demonstrate to global institutional investors our credibility and confidence in our own economy before we expect them to have a larger interest in our equity markets. This means that our domestic institutional investor base should be widened. Good candidates to demonstrate that for us are regional and domestic sovereign wealth funds," argues Kurdieh.

Some of the fundamental issues raised above are being addressed by concerned authorities, but a lot more needs to be done. Nevertheless, it is the right time to focus on these issues, as the slackening in market activity provides a lot of time and space to correct loopholes and work towards building a stronger market. It is also time to re-focus, consolidate, communicate better and enhance awareness and confidence among all stakeholders.

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Regional country-wise market cap to GDP ratio

Code	Market cap to GDP				
	2005	2006	2007	2008	2009**
Saudi Arabia	200.5%	89.8%	133.0%	52.7%	45.5%
Kuwait	160.5%	134.0%	211	78.2%	56.8%
Qatar	206.7%	108.1%	93	99.2%	65.8%
Oman	41.7%	36.6%	23	31.8%	25.2%
UAE*	174.9%	103.3%	257	57.8%	49.7%
Bahrain	130.7%	134.8%	27	92.2%	76.2%

Source: Bloomberg, Zawya & Global Research. *DFM & ADSX ** As of January 19, 2009