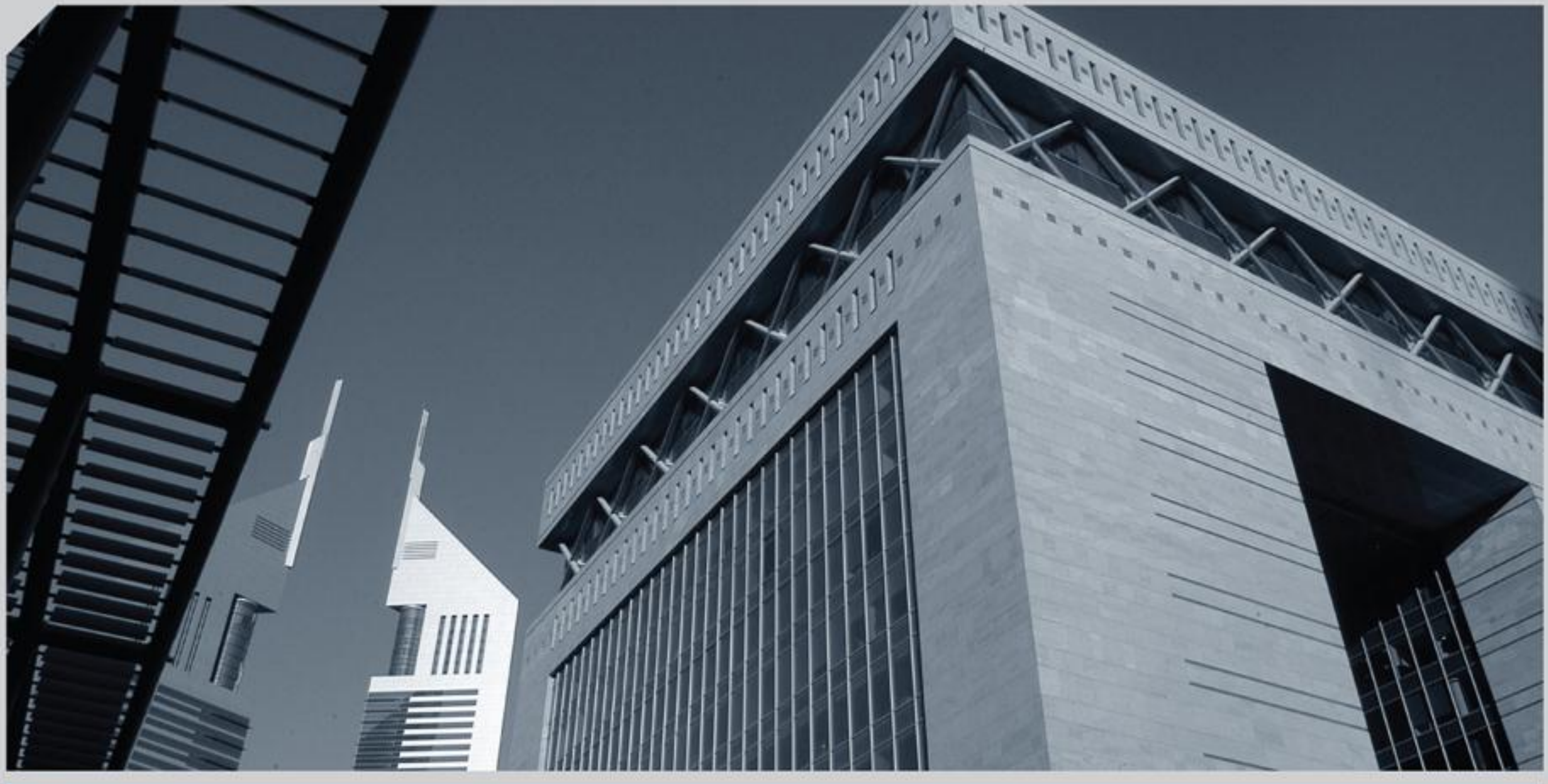

Developing Debt Markets: a Regional Imperative

DIFC Knowledge Series 4: Structuring and Issuing Bonds and Sukuk

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Developing Debt Markets: a Regional Imperative

- Debt market Development: A Regional Necessity
- Financial Underdevelopment of MENA
- GCC Debt Markets: an Opportunity to transform GCC Economies
- Developing Debt Markets in the DIFC

Debt Markets: a Regional Necessity

Introduction

- MENASA/GCC countries need long-term finance:
  - Diversify sources of government & corporate finance
  - Housing and Real Estate
  - Infrastructure projects
  - Public Works
- Banking system has been main source of financing. Need to reduce:
  - Currency mismatch
  - Asset/liability mismatch
- Capital Markets can and should be used to raise long-term financing:
  - Both the private and government/public sectors
  - Both Local and International issuers
  - Local and International currencies
- Develop:
  - Government Debt Market
  - Corporate Debt Market including convertible debt
  - Conventional and Sukuk

Debt Markets

- Debt securities form the largest financial market
- Capital markets are not inherently superior to bank financing; but diversified financial systems are superior to simple bank-based systems
- Domestic bond markets can be developed: “Original sin” is not mortal
- Well-functioning and liquid debt markets contribute greatly to the efficiency and stability of financial intermediation and to economic growth in general
- Represent the leading channel of liquidity for government, public companies, agencies and financial institutions in many advanced economies.

Benefits of Local Currency Debt Markets

- Developing debt markets in local currencies allows small open economies to

  1. Deal with currency and maturity mismatches
  2. Absorb volatile capital flows & Reduce financial instability
  3. Provide institutional investors instruments that satisfy their demand for safe and stable long term yields
  4. Grant a stable source of capital to fund public and private ventures under the constant scrutiny of markets

Diversification, Market Discipline, Pension Systems

- Issuing debt securities allows a wider diversification in the supply of funding for the public and the private sector, especially in project finance.
- They enhance market discipline, transparency and accountability
- Intergenerational transfers through the pension system is another fields where the role of debt markets is crucial
- Expatriates do not have social security coverage: there exists a natural demand for safe securities that at present is met by international assets allocation for lack of domestic alternatives

Public Debt Management

- Massive infrastructure plans are already straining public sector management & financing capabilities
- Private sector should be called upon to participate, finance and complete a large portion of these projects

➢ The current downturn has pushed many government budgets into deficits

➢ A liquid local market would greatly improve debt management in terms of:
  - Diversifying maturities and standardizing the securities
  - Achieving a balance between Islamic and conventional bonds
  - Transparency in pricing and intermediation
  - Constant monitoring of macroeconomic stance and expectations
  - Disclosure of information and periodic communication regarding public policies

Benefits of Project Financing

- Wider adoption of project financing would lead to
  - A more rigorous cost-benefit analysis in public projects
  - Suitable match between debt maturity and cash flow
  - More professional evaluation of financial, construction and regulatory risks
  - More Efficient Management,
  - More Rigorous Cost Controls
  - Better Accountability
  - Greater Transparency

Government Sukuks and Legal Homogeneity

- Islamic Jurisprudence is not homogeneous and Fatwas are not bound to precedents, hence the lingering uncertainty on the validity of some contracts or structures impairs the establishment of standard.

- This hurdle can be overcome with a multiyear plan of issuances by sovereign borrowers with periodic auctions and scattered maturities.

- This would serve three purposes:

    - create a benchmark

    - give raise to a “profit sharing curve”

    - foster issuances of similar securities by banks and corporations

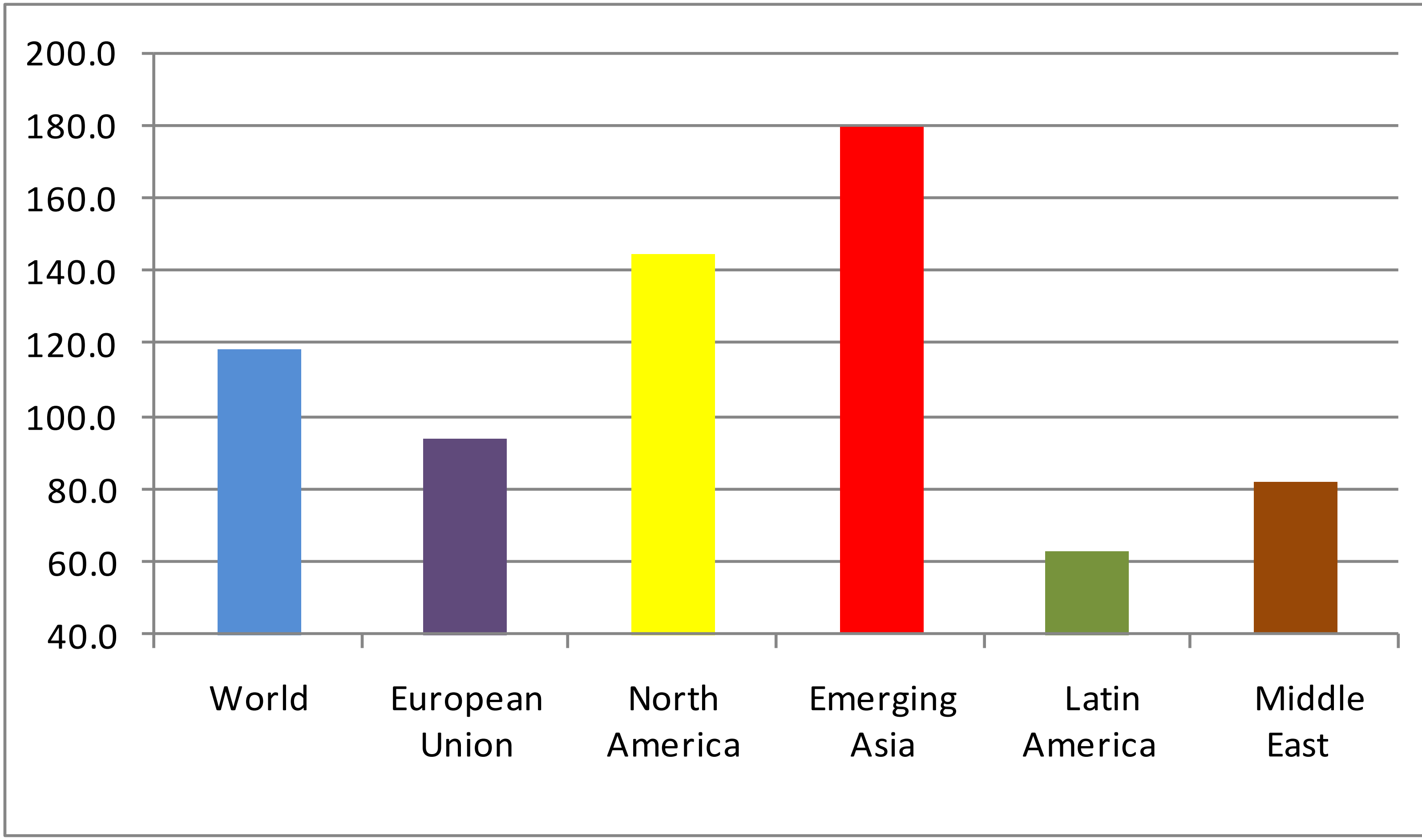
- Ratings would be affected only by creditworthiness of the borrower

Monetary Policy

- Fixed income securities are pivotal for the efficient conduct of monetary policy especially if the central bank has to maintain an inflation target without a peg to a major currency.
- Gulf Monetary Union countries will need a well developed local currency debt market to gain monetary independence and steer the economy through interest rate moves
- Monetary policy moves can affect the shape of the yield curve thereby enhancing the ability of the central bank to influence the real economy.

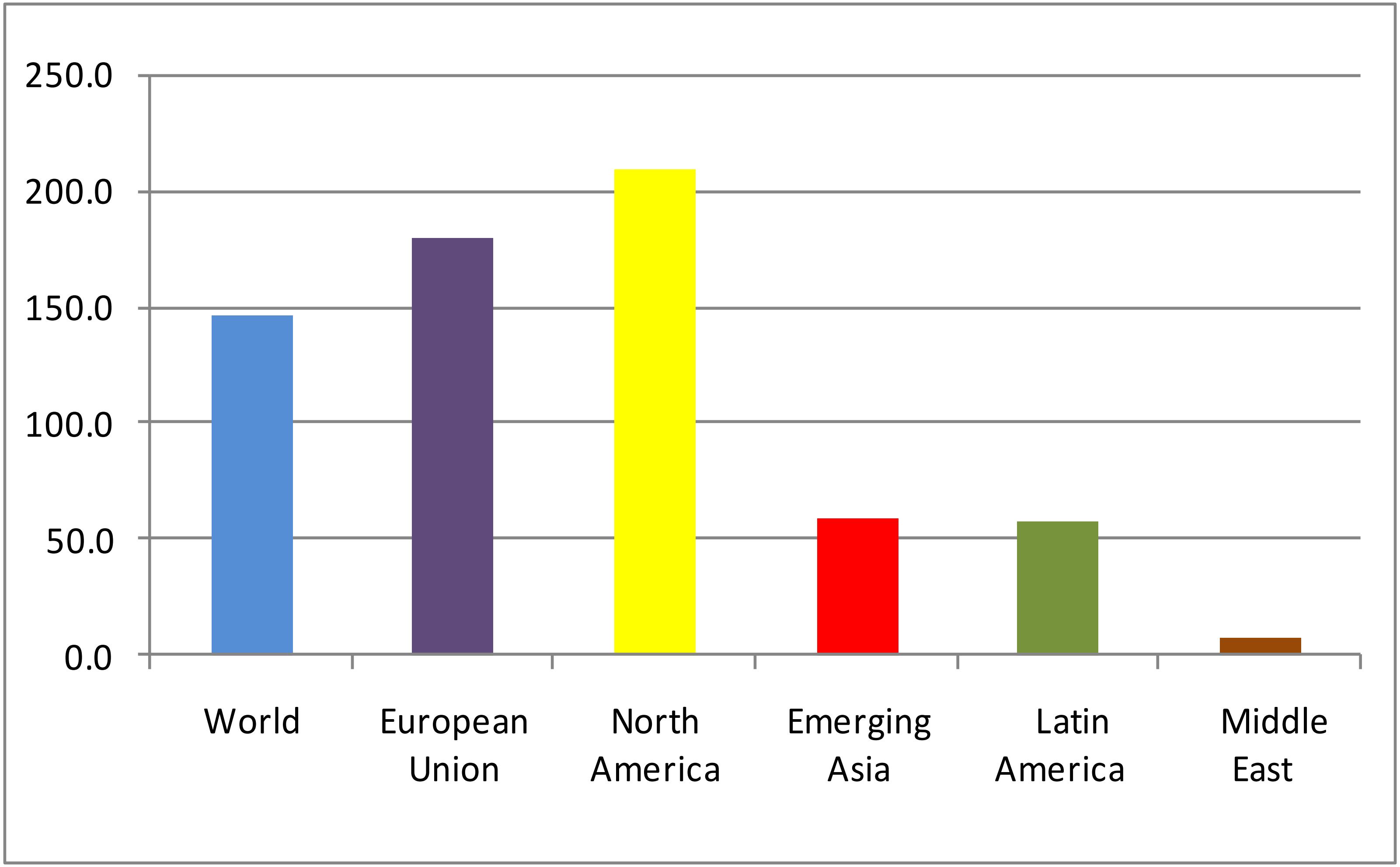
Financial Underdevelopment of MENASA

Stock Market Capitalization – 2007 (as % of GDP)



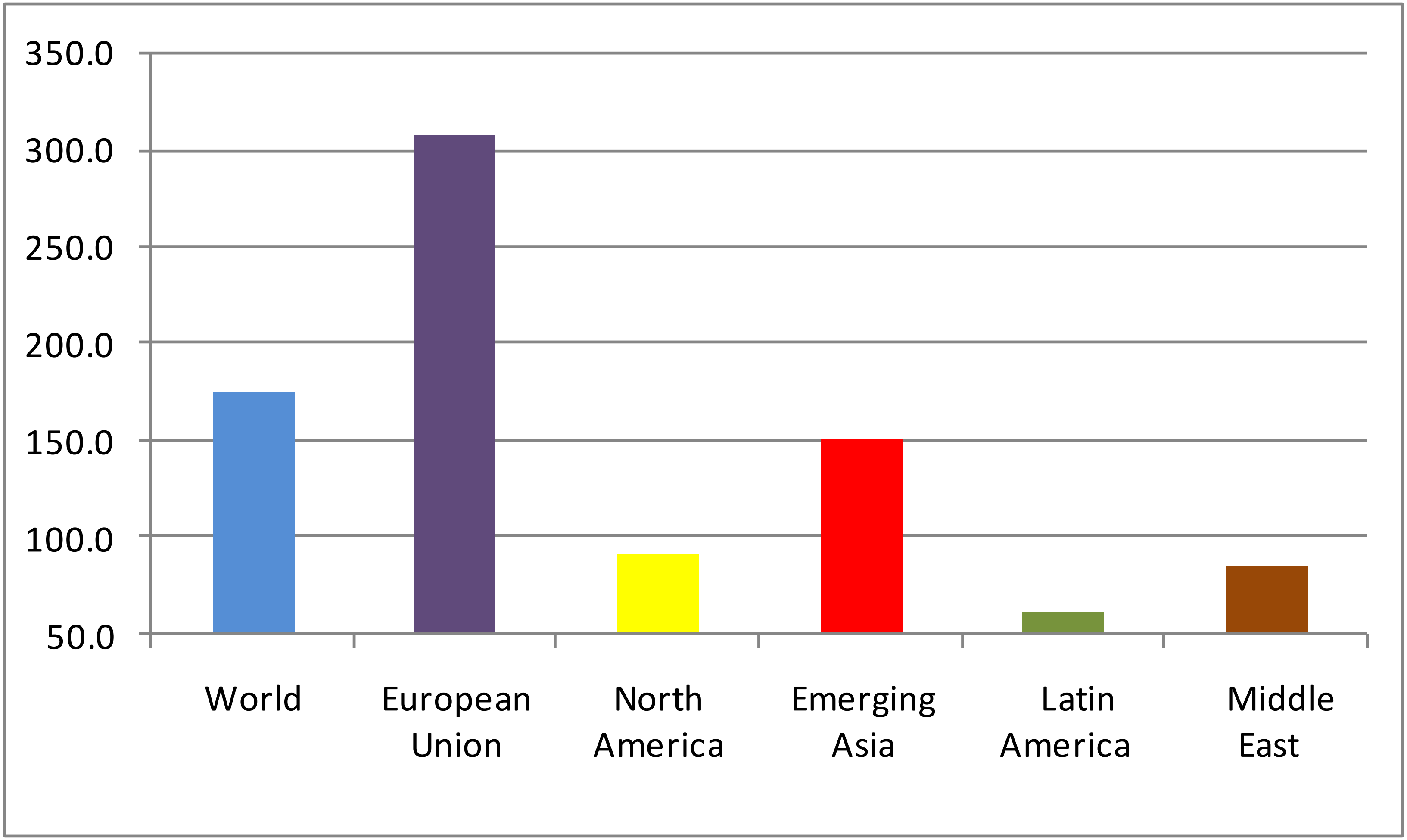
•Source: IMF Global Financial Stability Report, April 2009

Total Debt Securities, 2007 (as % of GDP)



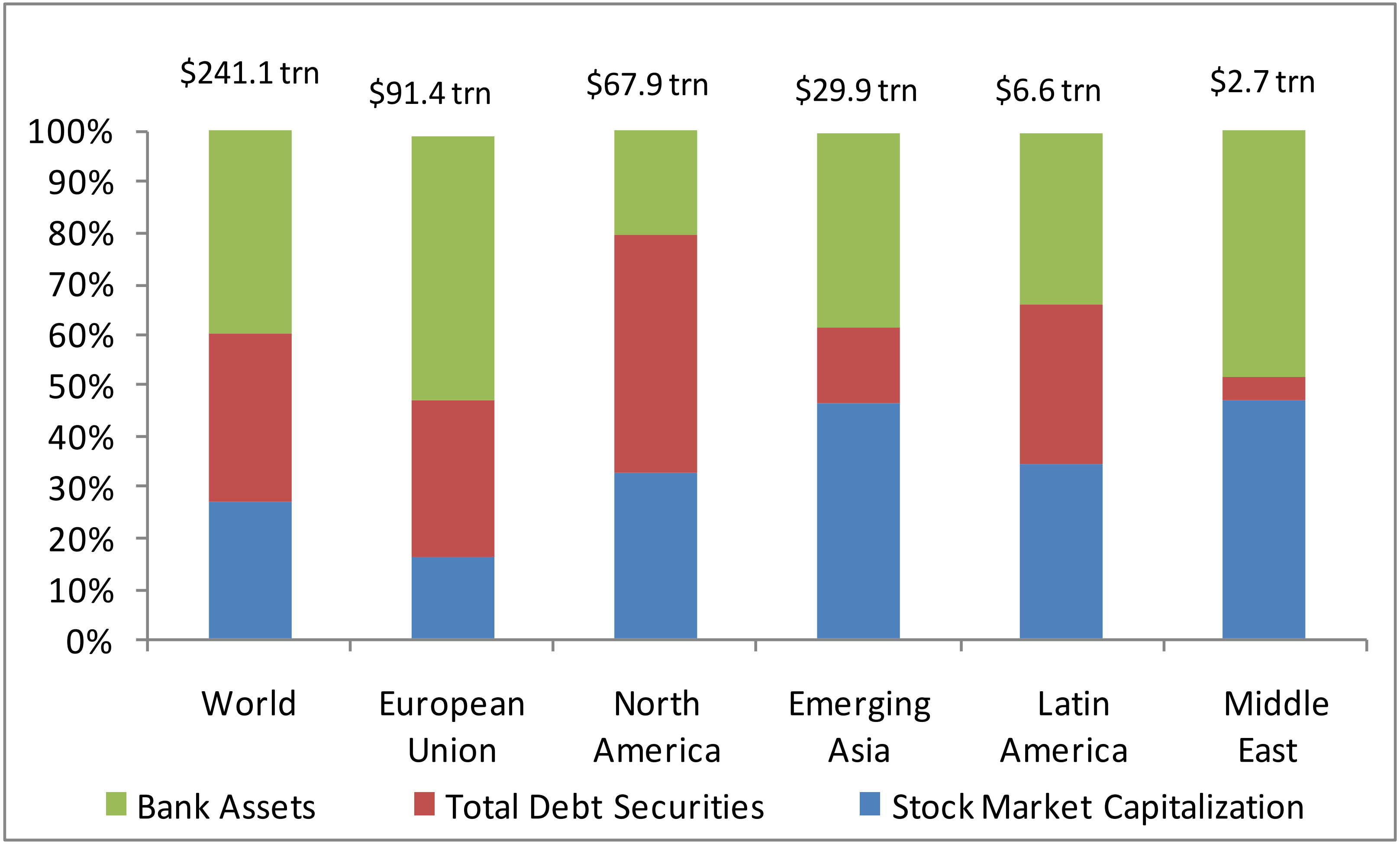
•Source: IMF Global Financial Stability Report, April 2009

Bank Assets, 2007 (as % of GDP)



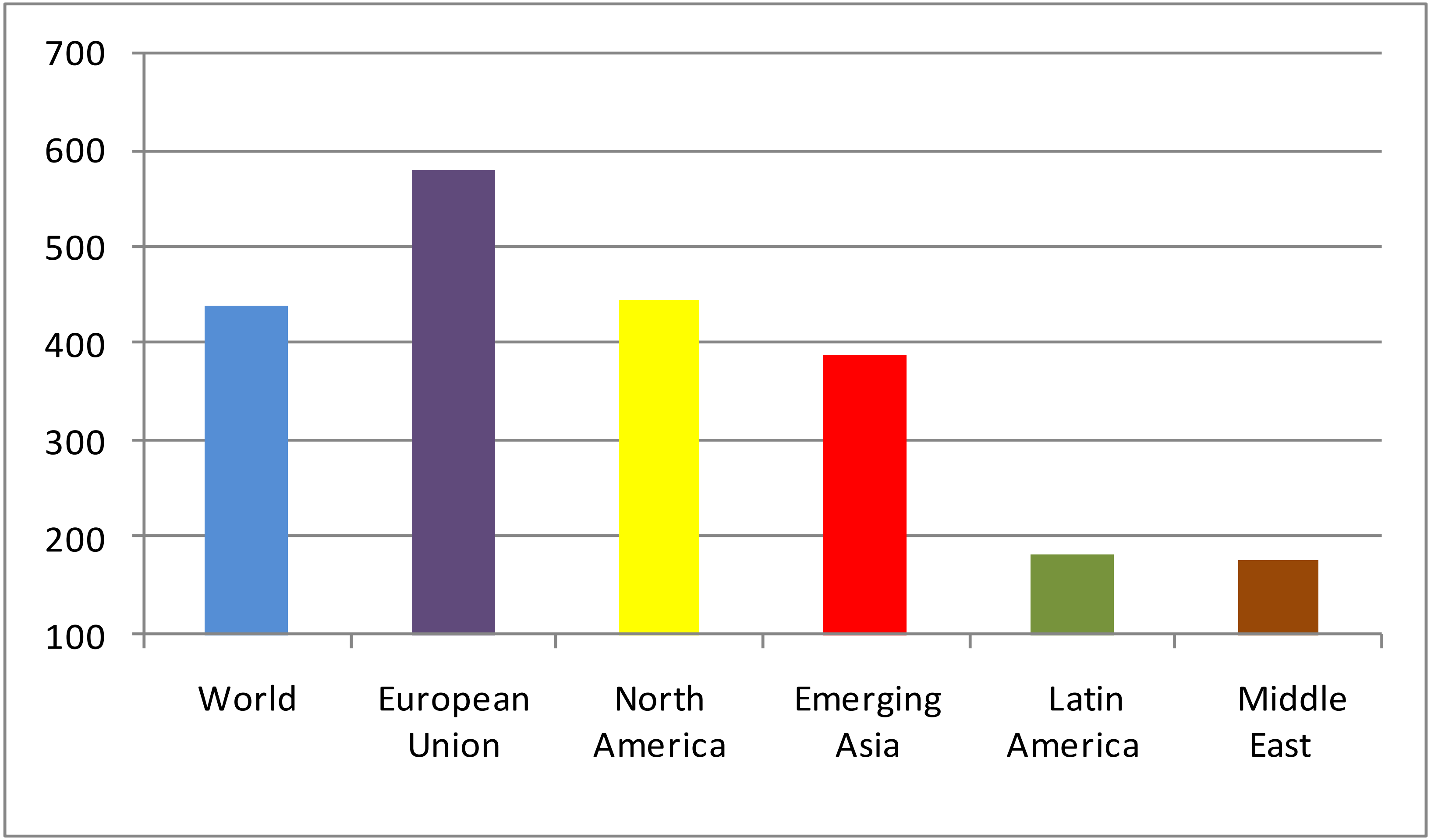
•Source: IMF Global Financial Stability Report, April 2009

Financial Structure Across Regions, 2007



•Source: IMF Global Financial Stability Report, April 2009

Financial Depth: Bonds+ Equities + Bank Assets, 2007 (% of GDP)

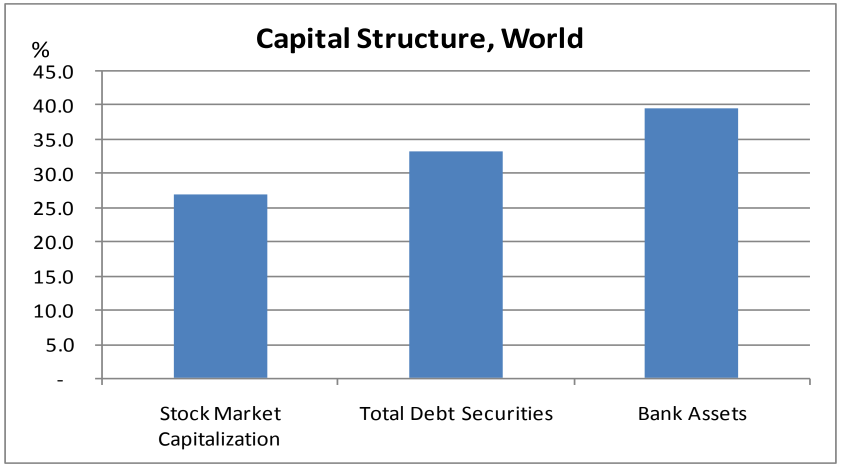


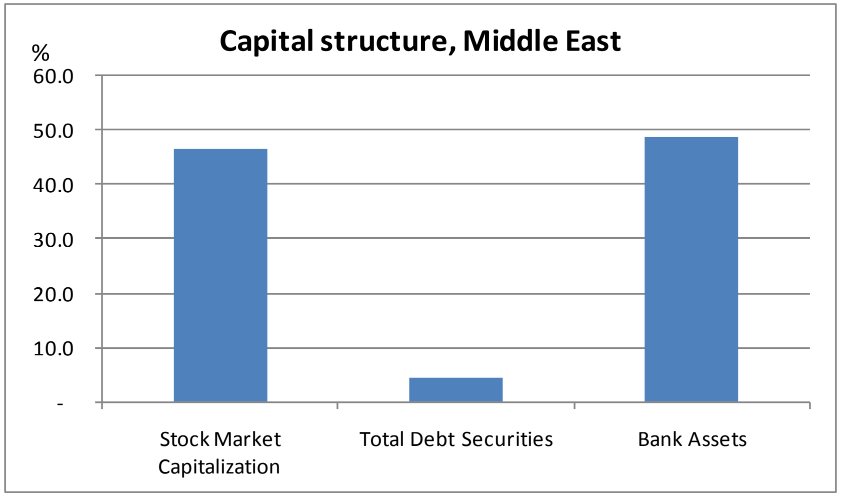
•Source: IMF Global Financial Stability Report, April 2009

GCC Debt Markets: an Opportunity to transform GCC Economies

Characteristics of GCC Bond Markets

- **Banking sector is still the major source of funding for the region's corporations.**
- **While world capital markets show on average a balanced capital structure of 33.3% debt securities, 27% stock market capitalization and 39.7% bank assets, the Middle East's balance is heavily skewed towards bank assets (48.8%) and stock market component (46.6%). Debt securities still play a minor role with only 4.5%.**
- **Though primary issuance has increased in past 2 years, the bond and Sukuk markets of the GCC countries still lack important ingredients of a well functioning debt capital market:**
  - **No rating culture, no market transparency, lack of benchmarks, no long maturities, lack of a broad spectrum of market participants, absence of a derivative market for managing interest rate and credit risk.**

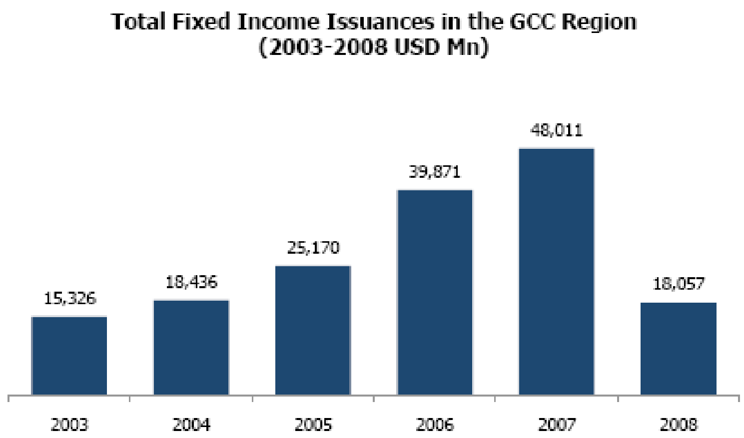


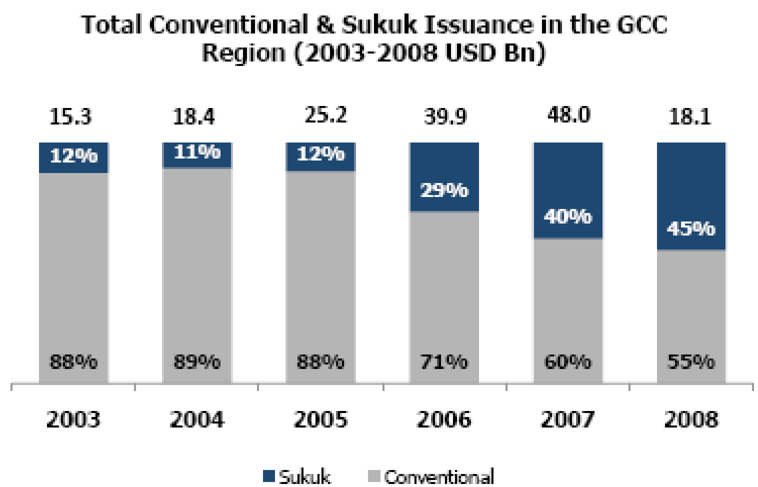


Source: IMF Global Financial Stability Report, April 2009

Bond & Sukuk Market in GCC

- In 2008 , the GCC aggregate bond market, which includes both conventional and Sukuk dropped 62.4% comparing with the amount raised in 2007.
- The total number of issuance was 34 conventional Bonds and 42 Sukuk
- Share of Sukuks continued to grow in 2008, up 44.80% from 40% in 2007 of total value issued by GCC bond market
- Conventional issuances still raised a greater amount with USD9.98 billion, representing 55.2% of the total value raised, compared to USD8.1 billion for Sukuk
- Majority of the listed Bond and Sukuk issues were listed on Nasdaq Dubai. Of the 2008 issuances, 7 were listed on various regional exchanges; 6 Sukuk listed on the NASDAQ Dubai and 1 Sukuk listed on the Saudi Stock Exchange.
- UAE issuers account for around two-thirds of GCC bond market volumes.
- Total Sukuks outstanding are likely to reach USD 100 billion in 2009, according to Standard & Poor's, and it may go on to grow 35% over the next 2-3 years.
- The HSBC GCC Bond Index was down about 20 per cent in 2008, this compared to a decline of 70 per cent in the DFM, and more than 40 per cent in most other regional and global equity markets.





- Moody's: Global Sukuk Issuance (January 2009)
- Kuwait Financial Centre "Markaz" (January 2009)

Bond & Sukuk Market in GCC

Latest Developments in the MENA Bond Market

Abu Dhabi	Abu Dhabi announced in March 2009 that it intends to issue two tranches of US dollar denominated 5 and 10 year bonds
Bahrain	Bahrain announced in February 2009 that it will sell bonds with a total value of $800 million to finance real estate projects. The bonds are expected to be issued over the coming few months
Dubai	Dubai launched a bond issue in February 2009, the first tranche ($10 bn) of which was fully subscribed by the Central Bank of the UAE
Kuwait	Kuwait central bank announced in March 2009 plans to issue 200 million Kuwaiti dinars ($680.7 million) of one year Treasury bonds
Qatar	Qatar is preparing to sell 5and 10 year bonds, and in March 2009 it opened order books on it forthcoming two-part Dollar-denominated, benchmark (via Dow Jones)
Egypt	Central Bank of Egypt accepted offers worth 3 billion Egyptian pounds ($535.6 million) in an auction for reopened Bonds issued on Feb 24th.

Promise of GCC Bond Market

A developed GCC bond market could play a vital role in:

- Long term project financing and portfolio diversification
- Could lead to better capital access, efficiency gains and improved price discovery and risk assessment
- A conduit for small and medium enterprises to access the capital market

2009 & Beyond

- Regional corporates' need to secure funding has not evaporated since the global financial crisis escalated; more likely, demand remains in the pipeline
- Advent of a local currency bond market is an important step in the maturation of local capital markets
- With their relatively strong net asset positions, GCC sovereigns are good credit risks compared to their advanced economy peers.
- Successful sovereign bond issues would contribute to establishing a regional yield curve and form the basis for an increase in corporate bond issuance in the region

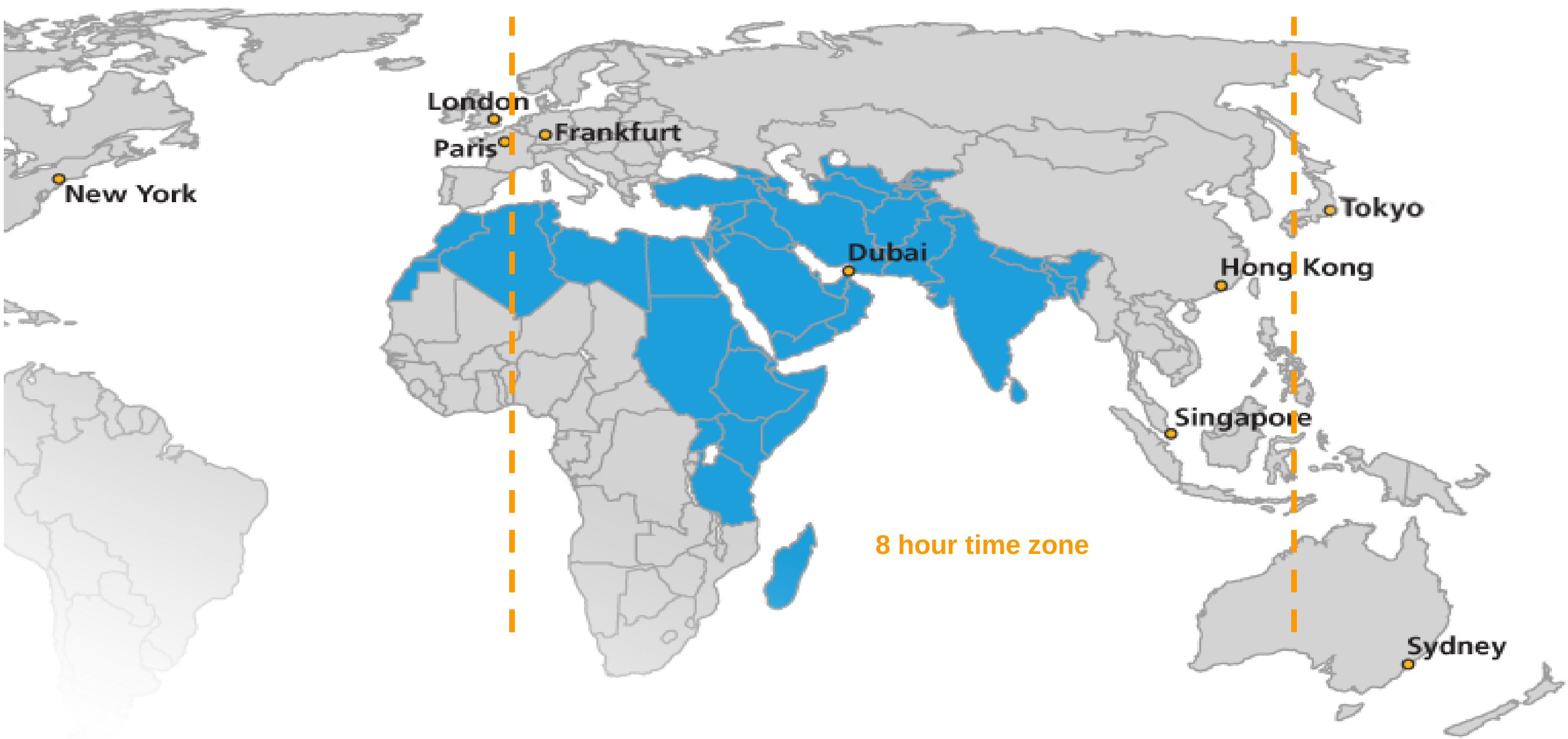
Source: IMF Global Financial Stability Report 2008

Bond Market Enablers

- Stable Macro environment: Monetary, Fiscal, Low Inflation, currency convertibility, absence of exchange controls, no exclusion of international issuers or investors
- Market Integrity, Transparency & Good Corporate Governance
- Robust Legal & regulatory framework
- Fees /Taxes environment ; Tax neutrality / tax friendliness
- Proactive governmental action and involvement
- Financial viability of projects
- Informed, Institutional investors
- Market structure in terms of regulation and participants, market associations
- Borrowers, lenders and intermediaries

Developing Debt Markets in the DIFC

DIFC – Time Zone Advantage



Dubai is 4 hours ahead of Greenwich Mean time (GMT)

5pm Dubai = 9am New York	1pm Dubai = 9am London	9am Dubai = 1pm Hong Kong

DIFC Structure & Organisation

- Over 26 laws & 16 regulations have been enacted establishing the basis for regulatory framework and allowing financial institutions to carry out activity in the DIFC.
- Tailor-made based on the best laws available in leading jurisdictions (e.g. Regulatory Law based on Common Law, Insurance Regulations based on Bermuda Law, Trust Law similar to Singapore and US regulations)

DFSA Dubai Financial Services Authority

- Sole financial regulator within DIFC, AML co-regulation with UAE Central Bank
- Administrative and civil rule making and enforcement
- Bilateral MOUs with host of jurisdictions
- IOSCO, BOCA Declaration (including multilateral MOU), IFSB, IAIS (Technical Committee) etc

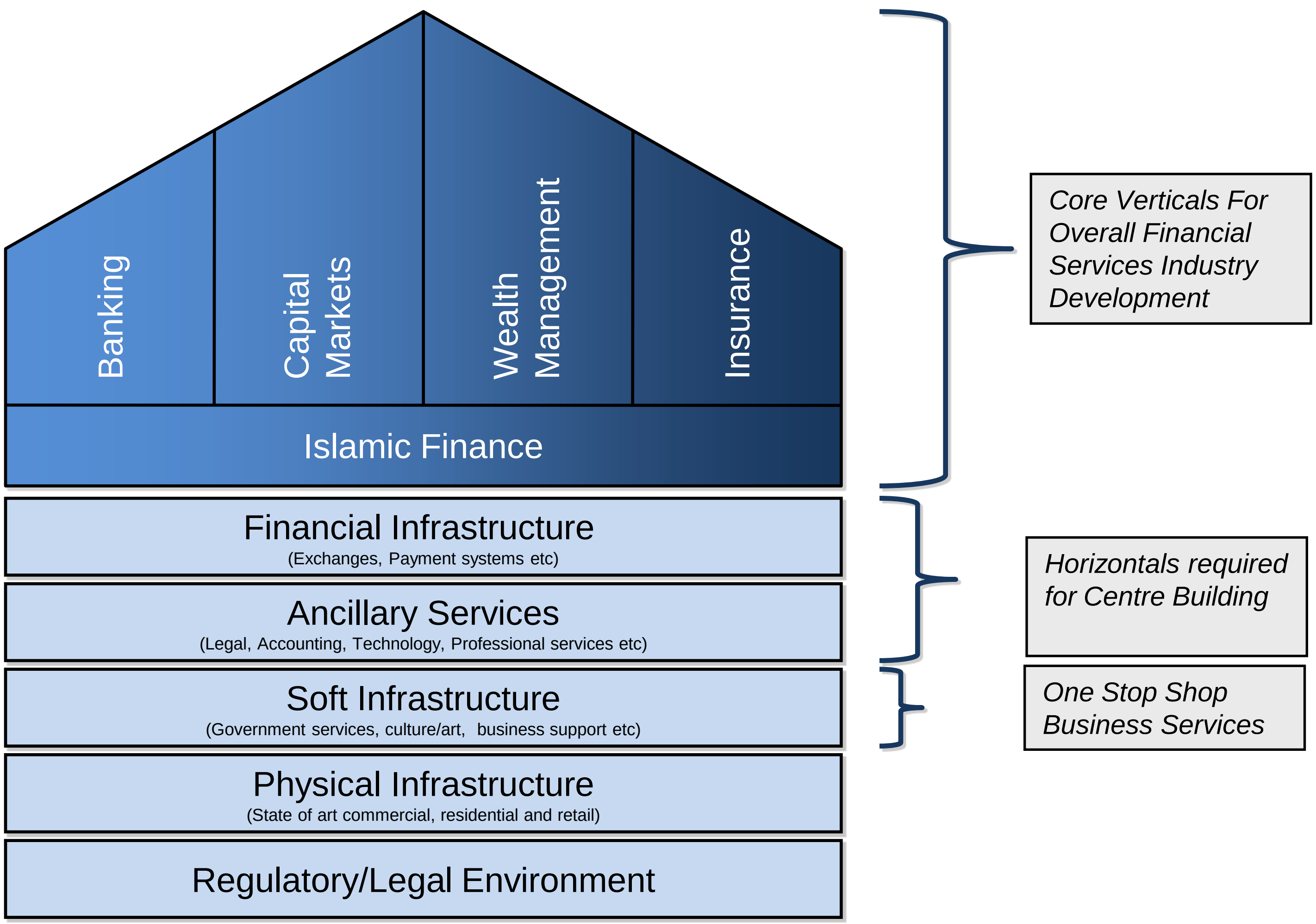
DIFC Dubai International Financial Centre

- Develop overall strategy and provide direction to the Centre
- Develop laws and regulations governing non-financial services activities
- Promote DIFC and attract licensees to operate in the Centre
- One stop shop service for visas, work permits etc

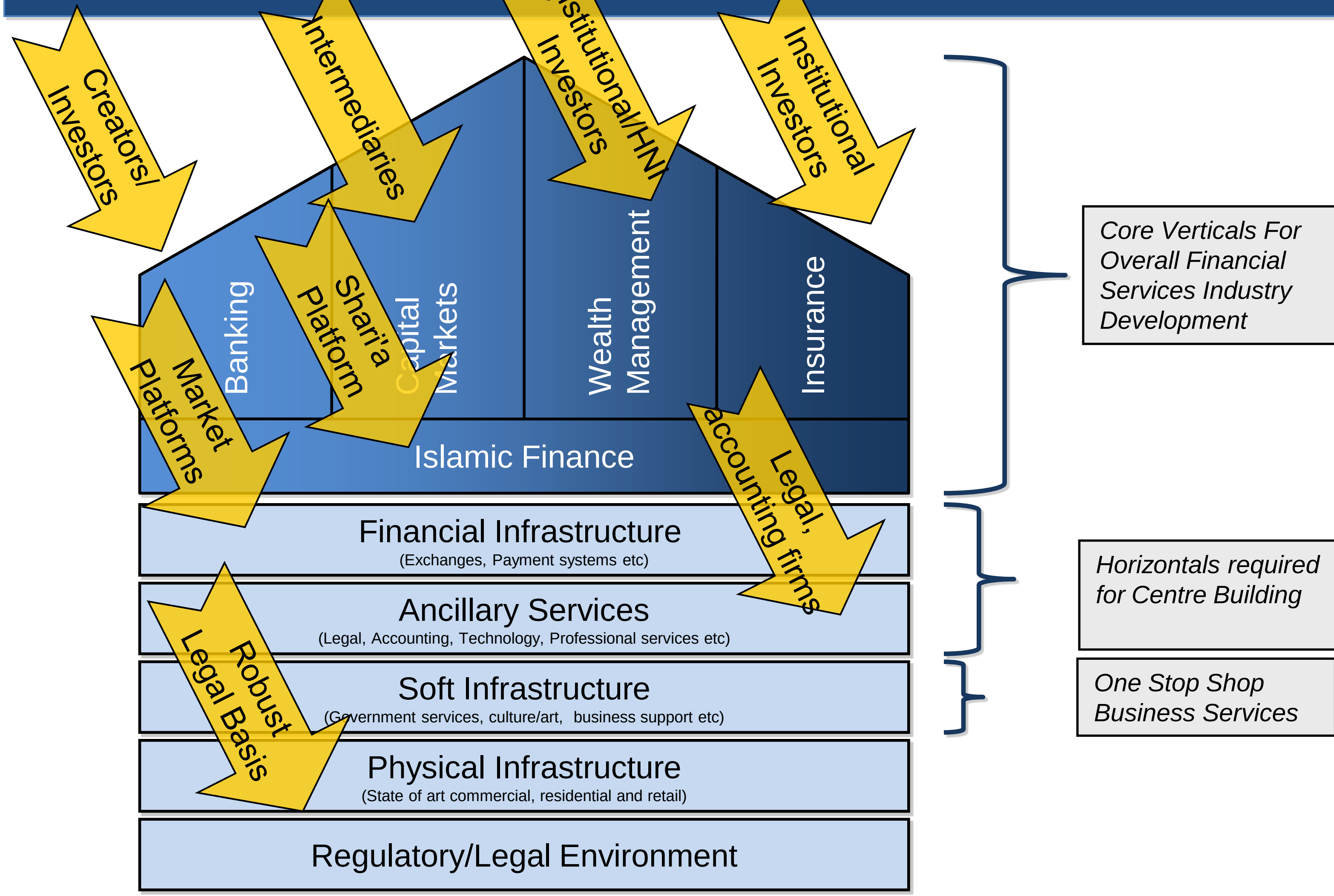
محاكم DIFC COURTS

- An independent court system responsible for administering and enforcing the civil and commercial matters at the Centre
- Based on Common Law-offering institutions and companies the legal clarity and predictability

DIFC: Ecosystem – Supports the 360º Development of the fixed Income Market



DIFC: Ecosystem – Supports the 360º Development of Debt Markets



DIFC Primary Sectors of Focus

- **Banking services**
  - There are commercial banks which can accept deposits and/or provide facilities to corporates including **trade finance** – including specialist banks engaged in shipping and aviation finance. Other activities include **project and infrastructure funding, treasury services and correspondent banking**.
  - Bulk of the licensees are dealing with institutional clients, but activities like lease finance, factoring and forfeiting are also accommodated to cater to SMEs.
- **Brokerage services:** The DIFC has established a critical mass of international and local firms offering **trading in Forex, equities, bonds, commodities, derivatives and CFDs**. Clients have the option to trade with Nasdaq Dubai within DIFC or any exchange worldwide.
- **Capital Markets:** The DIFC created Nasdaq Dubai (earlier DIFX) in 2005 to provide issuers and investors with a larger and more liquid securities market, currently non-existent anywhere else in the region (for **equity, debt instruments, derivatives and commodity trading)**. Nasdaq Dubai has already attracted dual listings of blue-chip firms and is attracting more global investors given the opportunity to invest in securities.

DIFC Primary Sectors of Focus

- **Wealth Management (Family Office, Trust Services):** The Family Office initiative promotes the Centre as an ideal location and domicile for family offices. This includes highlighting the world class financial services firms located at the DIFC and raising awareness among legal and accounting practitioners and families regarding the DIFC's legal and regulatory advantages that are relevant for family offices - **the DIFC Trust Law and the Single Family Office Legislation.**

- **Islamic Finance:** The DIFC
  - has **created an international base for providers of Islamic financial products**, including Sukuk, that meet the needs of both institutional and individual investors.
  - also **offers a new domicile for the registration of Islamic collective investment schemes**, reflecting an increasing investor preference for Shari'a-compliant investment products originating and managed in the region.
  - through the Nasdaq Dubai, **offers a deep pool of liquidity for the primary listing and secondary trading of sophisticated Islamic financial instruments.**

DIFC Primary Sectors of Focus

- **Asset Management & Fund Registration:**
  - The regulatory authority of the DIFC, Dubai Financial Services Authority (DFSA) has created a set of **Collective Investment Rules** which not only govern the activities of Domestic Funds but also permit the distribution of Foreign Funds.
  - **The Domestic Funds regime permits the establishment of traditional and alternative funds on both a conventional and Islamic basis through a full array of investment vehicles.**
- **Insurance/Reinsurance:** The DIFC has placed a particular focus on helping to serve the growing Takaful, or Islamic insurance, industry by **attracting Shari'a-compliant insurers and Reinsurers**. The DIFC has **created a hub to foster the development** of a thriving insurance and reinsurance market by attracting global insurance and reinsurance companies, brokers, captives and other service providers, enabling them to establish their regional operations in a single business base.
- **Ancillary Services:** DIFC provides **a fully robust platform and effective operating environment** to support the various types of activities and operational needs of financial institutions - **services include** accounting, tax, fiduciary and legal practices, actuaries, management consultants, recruitment firms, and market information providers, among others.

Legislative Developments

- **Retail Endorsement**
  - New rules permit firms to market and sell interests in domestic and foreign funds to retail clients and facilitate efficient fund operations by easing restrictions on delegation and outsourcing of fund administration and custody activities.
  - Expected to act as a stimulus to the investment funds industry in DIFC.
- **DIFC-LCIA Arbitration Centre**
  - Promote and administer the effective resolution of international business disputes through arbitration and mediation.
  - Based on a comprehensive and modern set of rules and procedures (UNCITRAL Model Law on International Commercial Arbitration)
- **Securitisation**
  - Regulations allow the set up of special purpose companies (SPCs) for the purpose of facilitating sophisticated financing activity under both Islamic and conventional finance.
- **Real-time Automated Payments in DIFC (RAPID)**
  - Real-time gross settlement (RTGS) payment systems infrastructure to institutions operating both within the financial district and the MENA region.
  - Multi-currency payments and clearing system for US Dollar, Euro, and other international currency transactions.

DIFC - Value Proposition

Clear & Transparent Legislation

DFSA: World Class Regulations

Window to a wealth of opportunities

A dedicated financial services cluster

Borse Dubai/Nasdaq Dubai: Liquid & Transparent International Exchange

Hawkamah Institute for Corporate Governance

DIFC Courts: Independent Judicial System

DIFC Education Strategy: Access to Talent

DIFC Resource Centre: Business Support Services

Developing Debt Markets: a Regional Imperative

- Witnessing the emergence of a GCC Bond/Sukuk market
- Developing Regional Debt Markets is an imperative:
  - Improved Fiscal policy discipline, management & control
  - Enable Monetary policy operations: REPOs, Swaps…
  - Finance Infrastructure, Development Projects and Public Works
  - Sever the link between energy revenues and capital spending leading to lower economic & financial volatility, breaking Oil-induced Boom-Bust Cycle
  - Enhance role of financial markets in channeling resources to their most productive use
  - Absorb liquidity growth resulting from energy revenues
  - Greater fluidity of financial flows and deepening of organized financial markets
  - Support and Enable GCC Economic & Financial Market Integration
  - Support & Enable GCC Common Currency & Monetary Policy

Thank you