THE CORPORATE RESTRUCTURING SUMMIT 2018

05-06 SEPTEMBER 2018
DUBAI, UAE

Building Blocks For Effective Corporate Debt Management

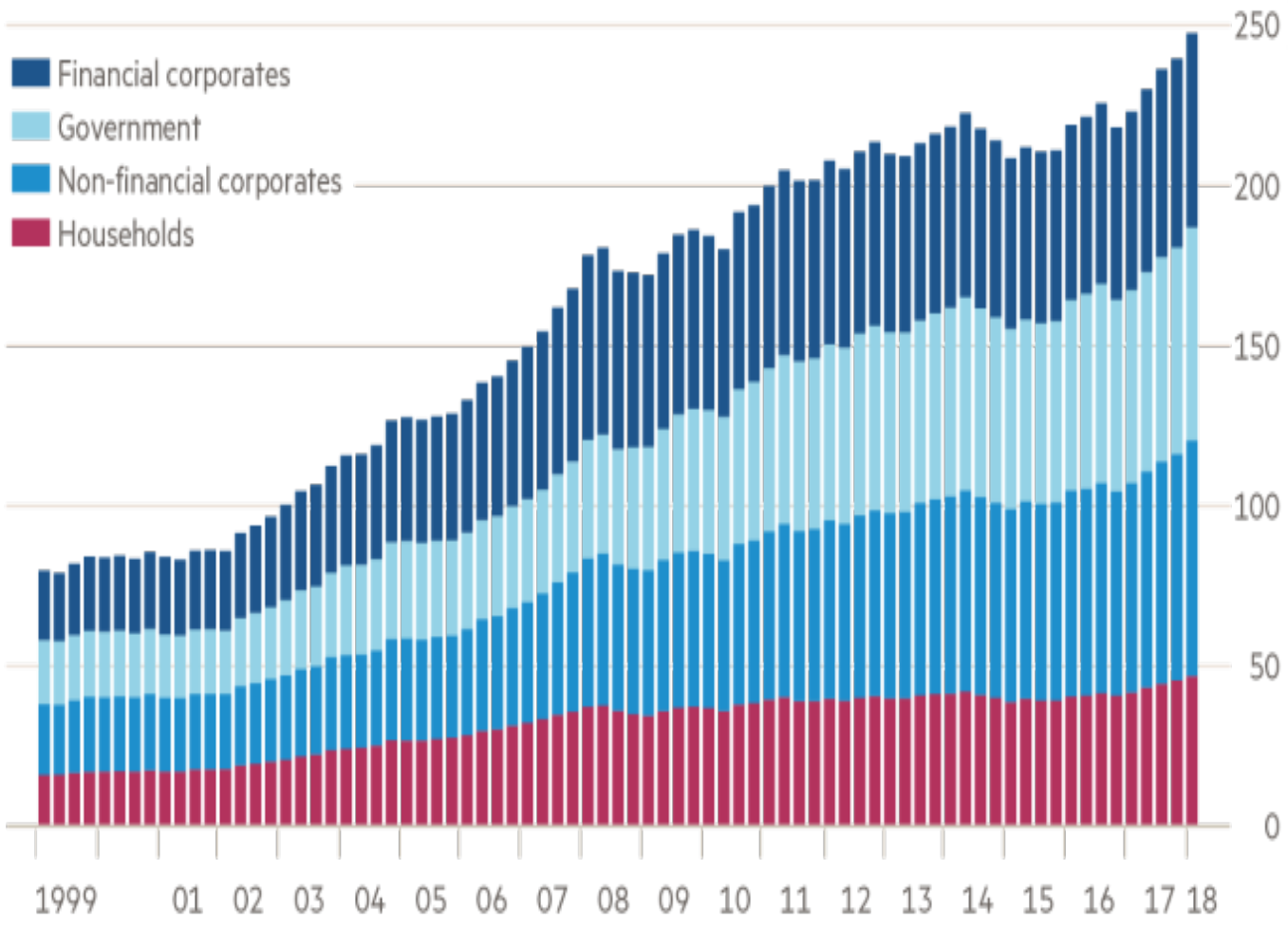
Keynote Address by Dr. Nasser Saidi

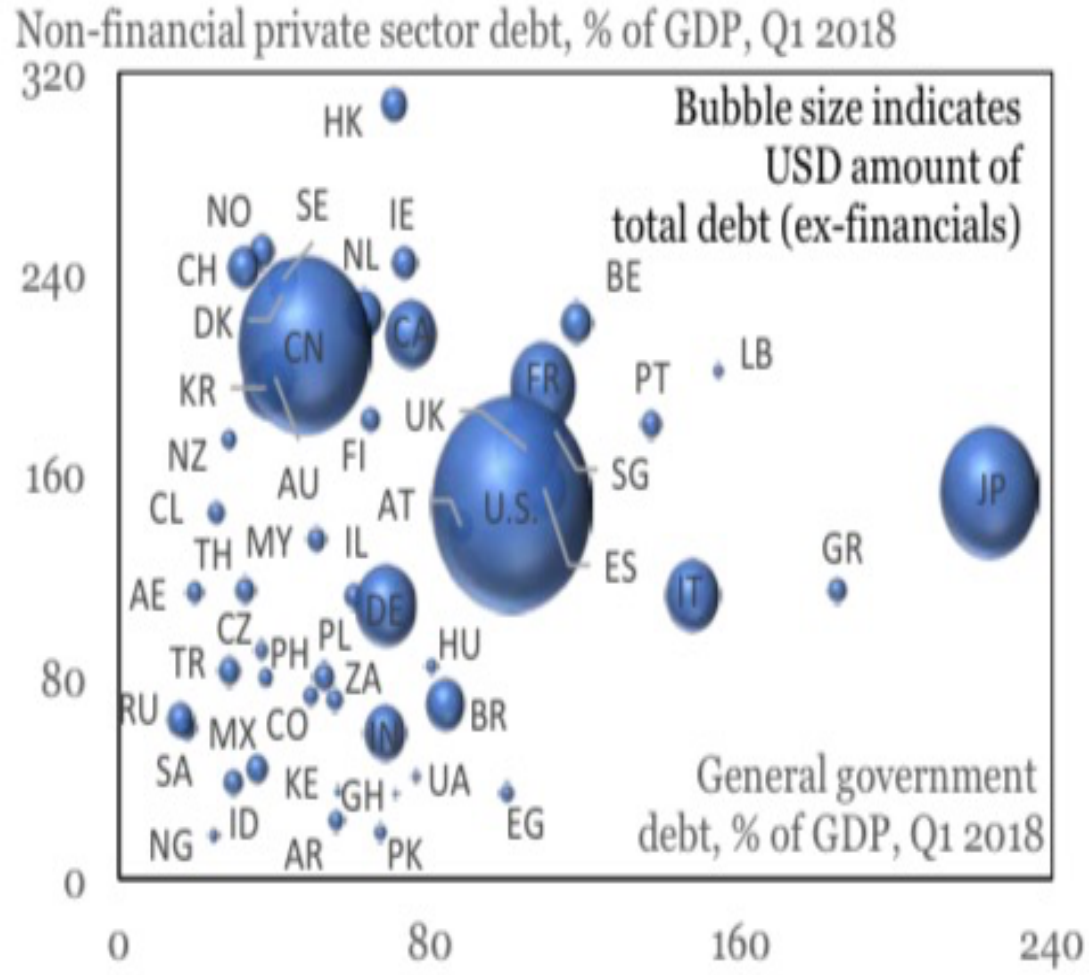
Agenda

- Global debt market & risks of monetary policy normalisation
- Are debt levels high in MENA/GCC?
- Developing GCC debt markets
- Debt market building blocks & reforms
- Key Takeaways

Strong Growth of Global Debt since GFC

Global debt tops $247 trn in Q1 2018: debt bubbles & higher credit risk with rising rates, a strong dollar & low levels of liquidity risk and trade wars are stoking volatility.

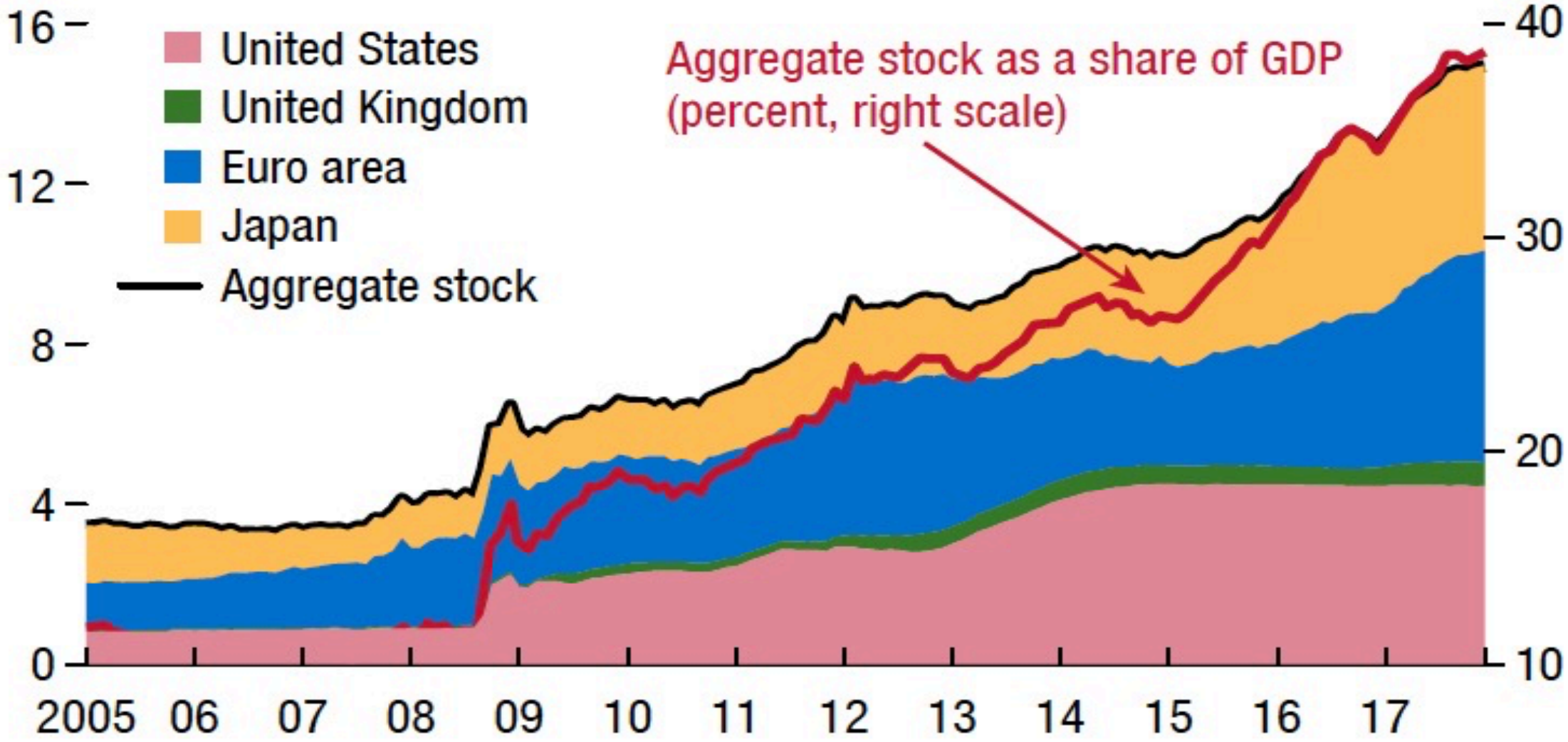




Source: Global Debt Monitor, July 2018, IIF

Bloated Central Bank balance sheets: Will Quantitative Tightening (QT) be source of next financial crisis?

Central Banks' Balance Sheet Assets (Trillions of US dollars), 2005-2018

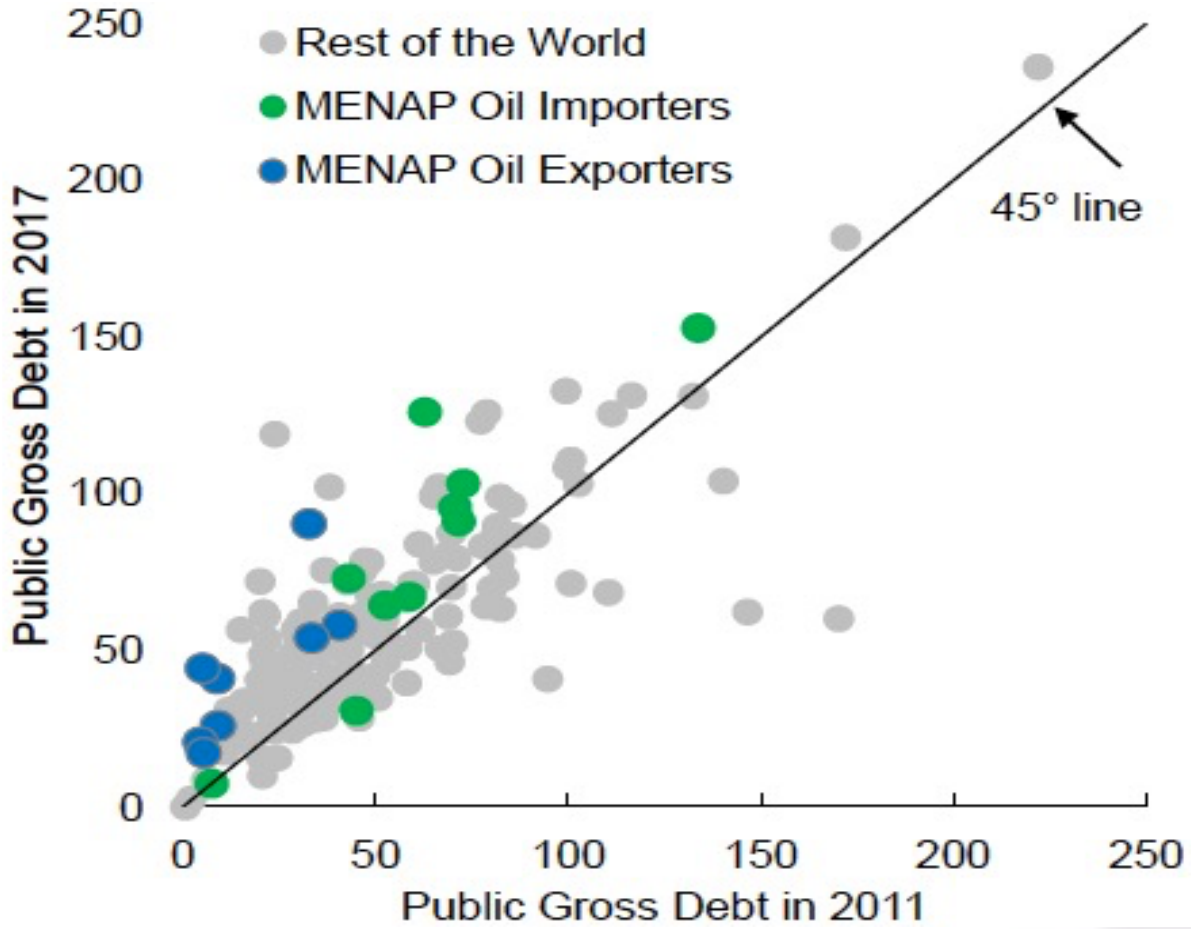


Source: Global Financial Stability Report, IMF, Apr 2018

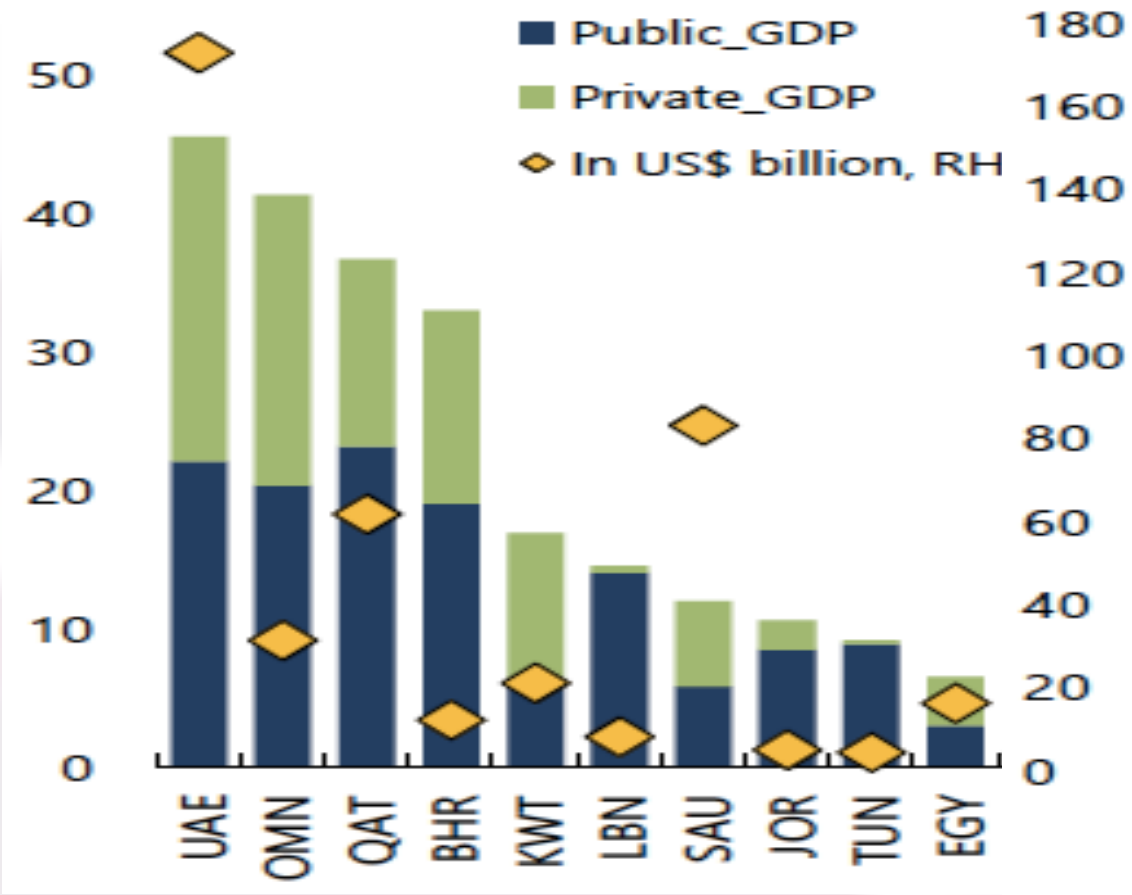
New Oil Normal has driven rapid debt growth in MENA: debt increased by an average 10% of GDP p.a. since 2013

Financing needs of $294bn + cumulative government debt amortizations of $71bn over 2018-22

Total public debt 2017 vs. 2011

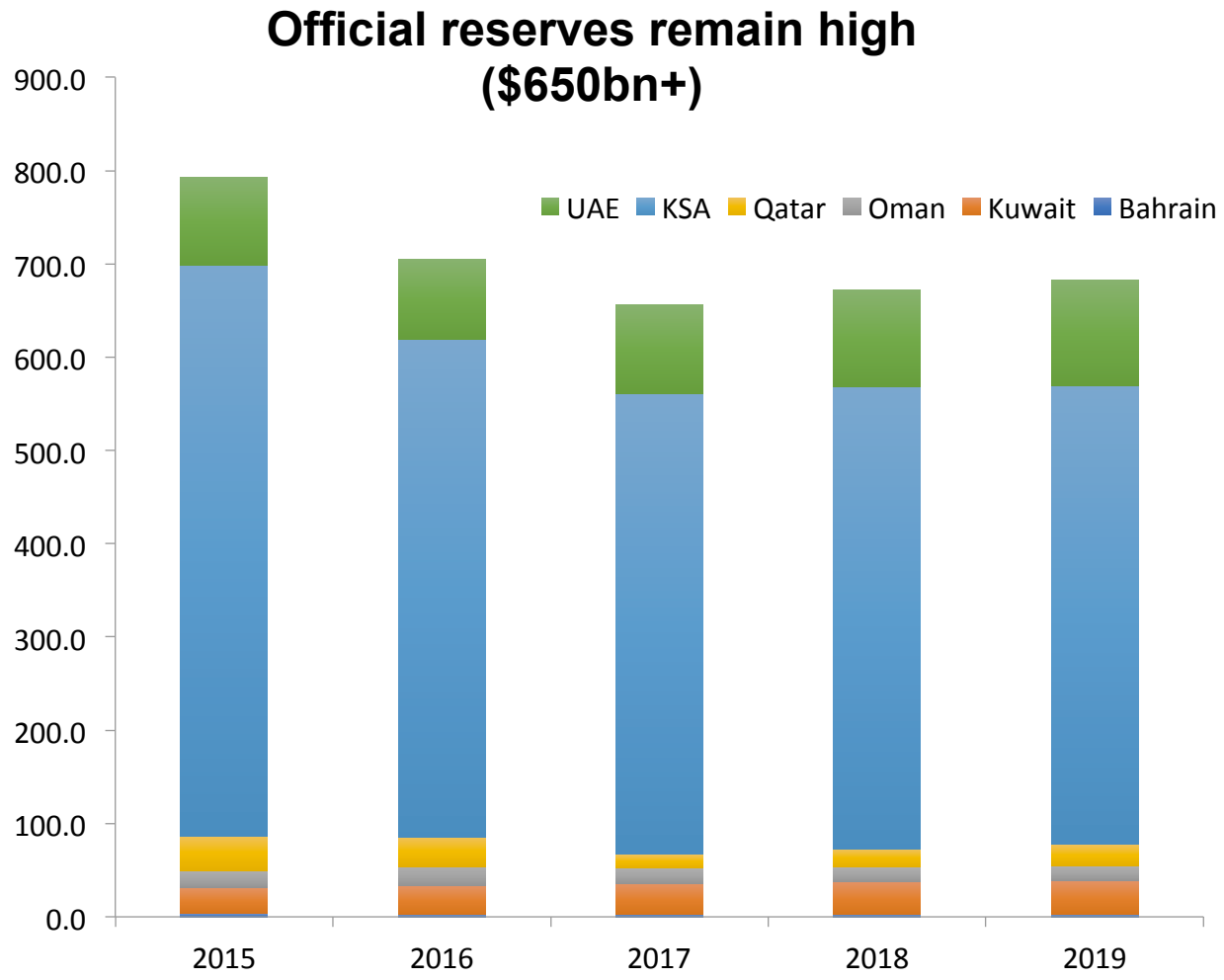


International debt maturing in 2018-22 (% of GDP)



Source: IMF Regional Economic Outlook, May 2018

GCC have low/moderate public debt-to-GDP ratios + accumulated savings: capacity is available to finance deficits & investment programs



GCC SWFs are still part of global Top 20

Sovereign Wealth Fund	Assets (USD bn)
Abu Dhabi Investment Authority	683
Kuwait Investment Authority	592
SAMA Foreign Holdings	494
Qatar Investment Authority	320
Saudi Public Investment Fund	250
Investment Corporation of Dubai	229.8
Mubadala Investment Company	125
Abu Dhabi Investment Council *(to be merged with Mubadala)*	123

Source: IMF Data

Source: Sovereign Wealth Fund Institute

New Oil Normal led to deterioration of macroeconomic conditions & liquidity and increase in NPLs in GCC

Macro: significant **inverse relationship between real (non-oil) GDP & NPLs**; global financial markets affect NPLs

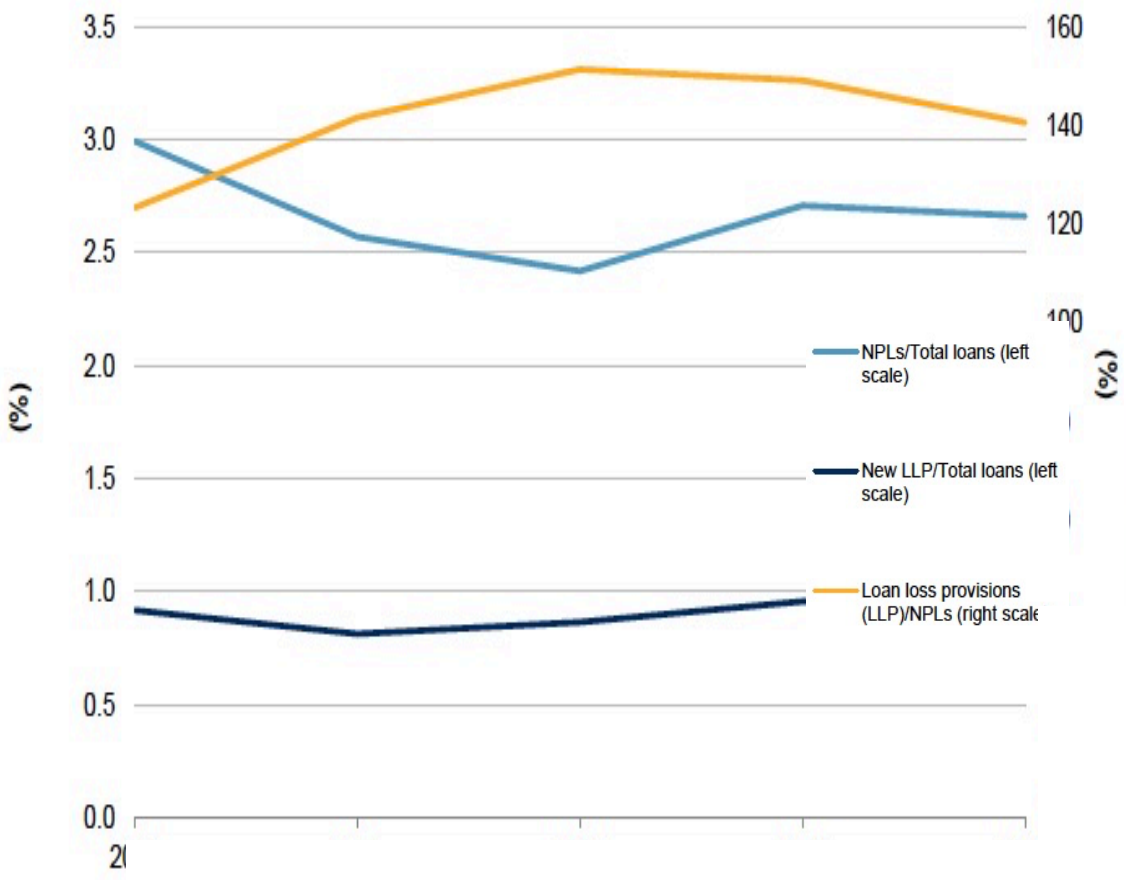
Bank-specific: operating efficiency, risk management & past expansion of B/S

Rising NPLs => strong albeit short-lived feedback effect on non-oil growth as banks cut back credit growth

Lesson: be wary of higher NPLs during periods of low growth and tight financing

Gulf banks have around 2.7x more problem assets than the NPL ratios suggest at year-end 2017 (S&P), if past-due but not impaired loans, and restructured exposures are included.

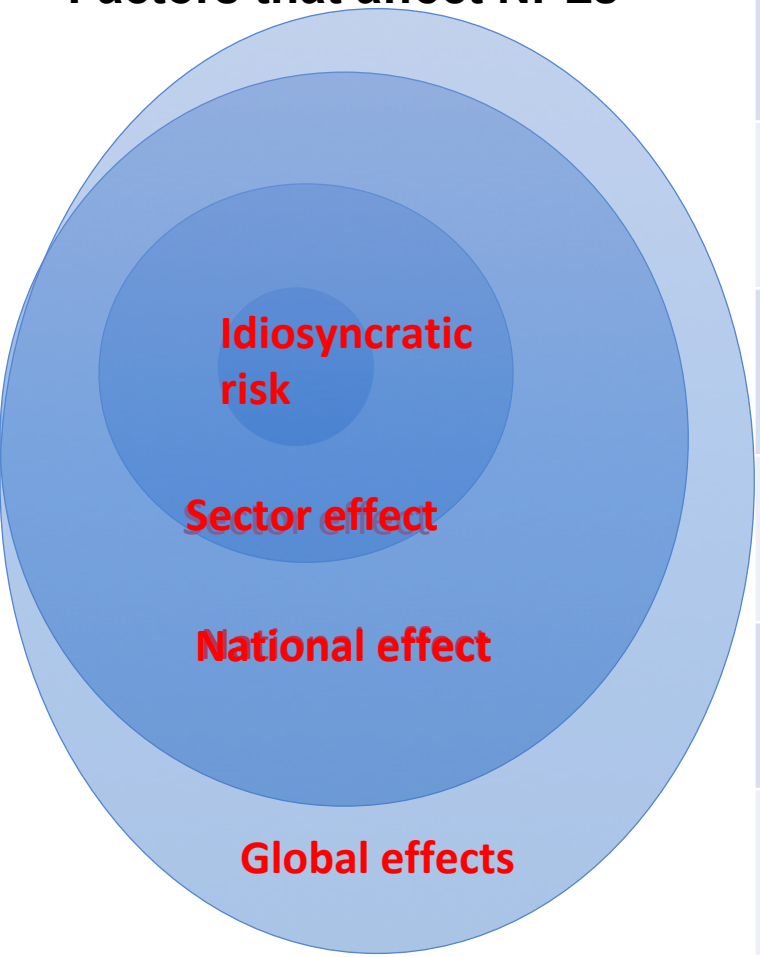
Rated Gulf Banks: Asset Quality Indicators



Source: S&P, Jul 2018

Non-performing loans in the GCC

Factors that affect NPLs



	NPLs (1995-2008)	Growth (1995-2008)	NPLs (latest available)	Growth (2017)
Bahrain	5.9	5.2	5.8 (Dec '17)	3.2
Kuwait	6.7	4.9	2.2 (Dec '17)	-2.5
Oman	6.5	3.3	1.8 (Dec '16)	-0.3
Qatar	3.1	11.7	1.5 (Jun '17)	2.1
Saudi Arabia	3.1	2.9	1.6 (Dec '17)	-0.7
UAE	4.3	5.8	6.7 (Sep '17)	0.5

2008-2010: NPLs touched double-digits; affected by oil shock + global financial crisis

Changes since 2007-8: Improvements in operational efficiency, better risk management, governance, credit information bureaus

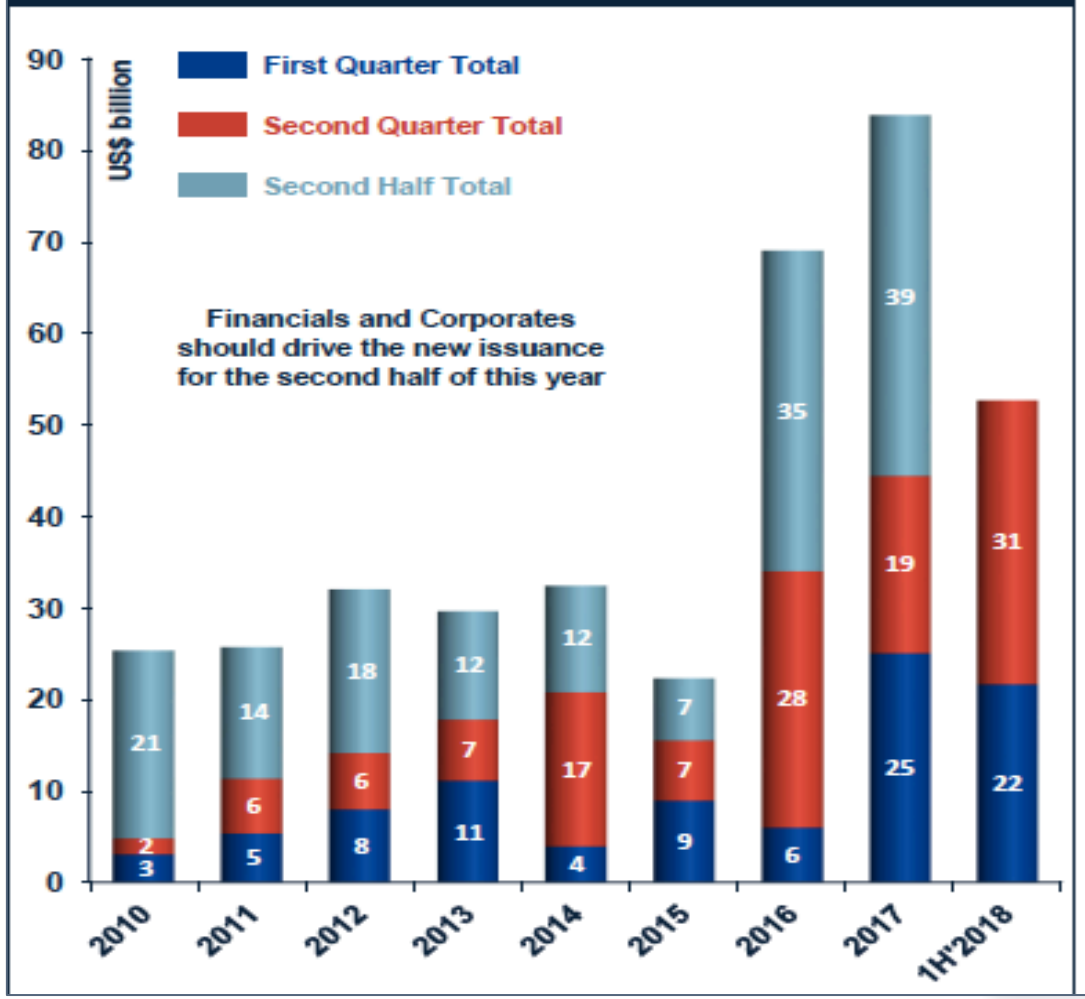
Recent NPLs: largely due to local shocks

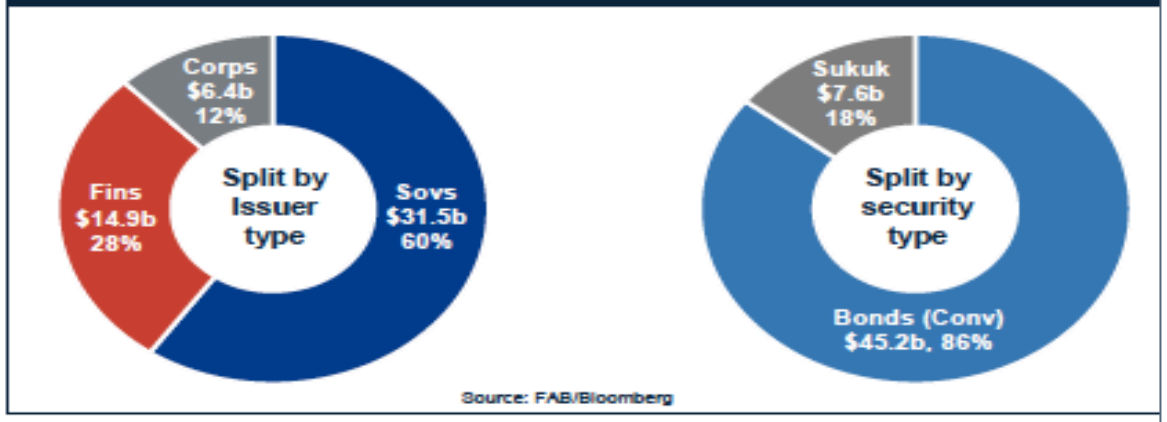
Indications that some loans with payment delays are **being restructured and not downgraded to nonperforming status**

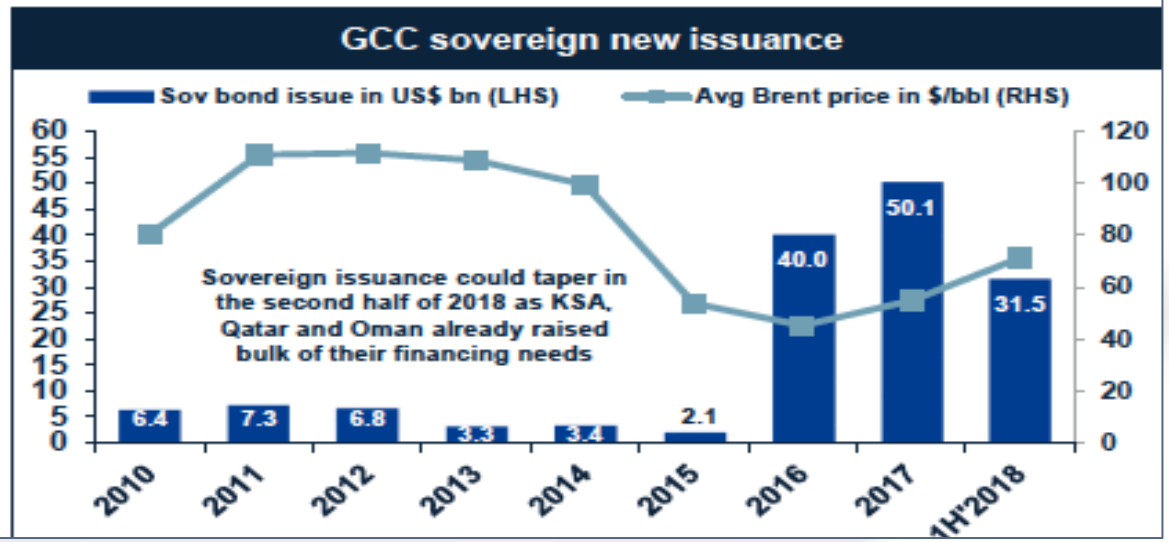
Source: IMF Regional Economic Outlook database, May 2018

Sovereign issuance continues to dominate GCC primary market

GCC topped EME sovereign bond issuance in H1 2018: risk of a glut outstripping investor appetite?

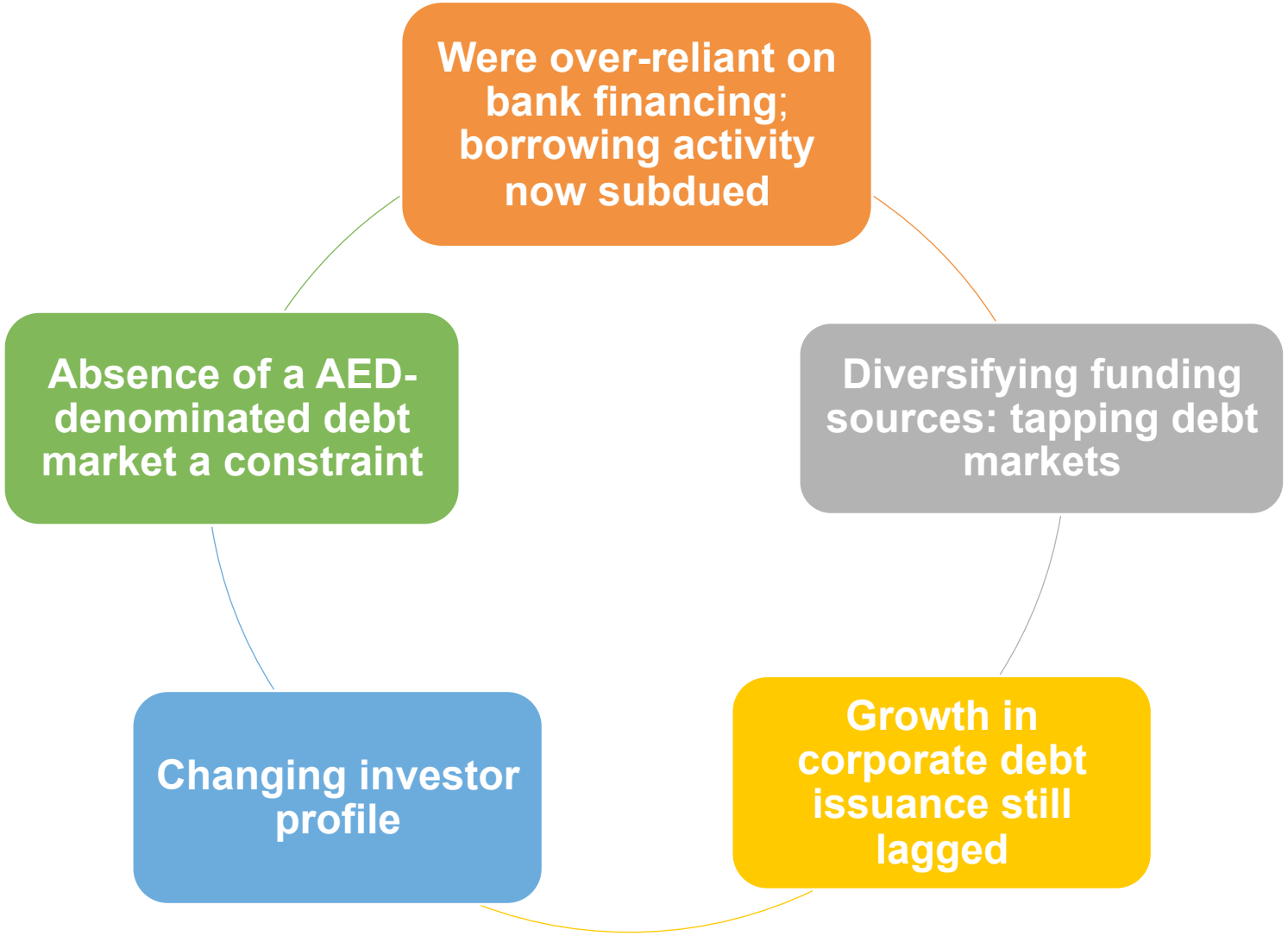






Source: First Abu Dhabi Bank

GCC Corporates & GREs



Key drivers of issuance: availability of capital, low GCC growth expectations, tempering of austerity measures

Risks: dollar peg, geo-political uncertainty/ political risk, pressure on GREs if sovereign credit quality deteriorates

Sectors at risk: pockets of risk in real estate/ construction, hospitality sectors

Need of the hour: development of large corporate entities, broader implementation of a rating culture, AND…

Need to Develop Local Currency Debt Markets to Support Financing

Facilitate financing for infrastructure & development projects

Absorb volatile capital flows and reduce financial instability

Provide institutional investors instruments that offer safe & stable long-term yields in local currency

Monetary Policy: tool for central banks to conduct monetary policy & control liquidity

Fiscal Policy: essential tool for deficit financing & to smooth volatility of revenues

Corporate finance: diversify from reliance on bank financing

Building Blocks For Corporate Debt Restructuring

Legal framework

- New, but untested, **bankruptcy laws;** extend DIFC Laws
- Introduce **securitization law**, facilitate M&A's
- Create framework to support **structured finance instruments**: ABS, MBS, CDOs, CLOs
- In the medium-/ long-term, develop **distressed debt markets**
- **Decriminalize bounced cheques**
- **Build capacity** of the courts

Regulatory changes

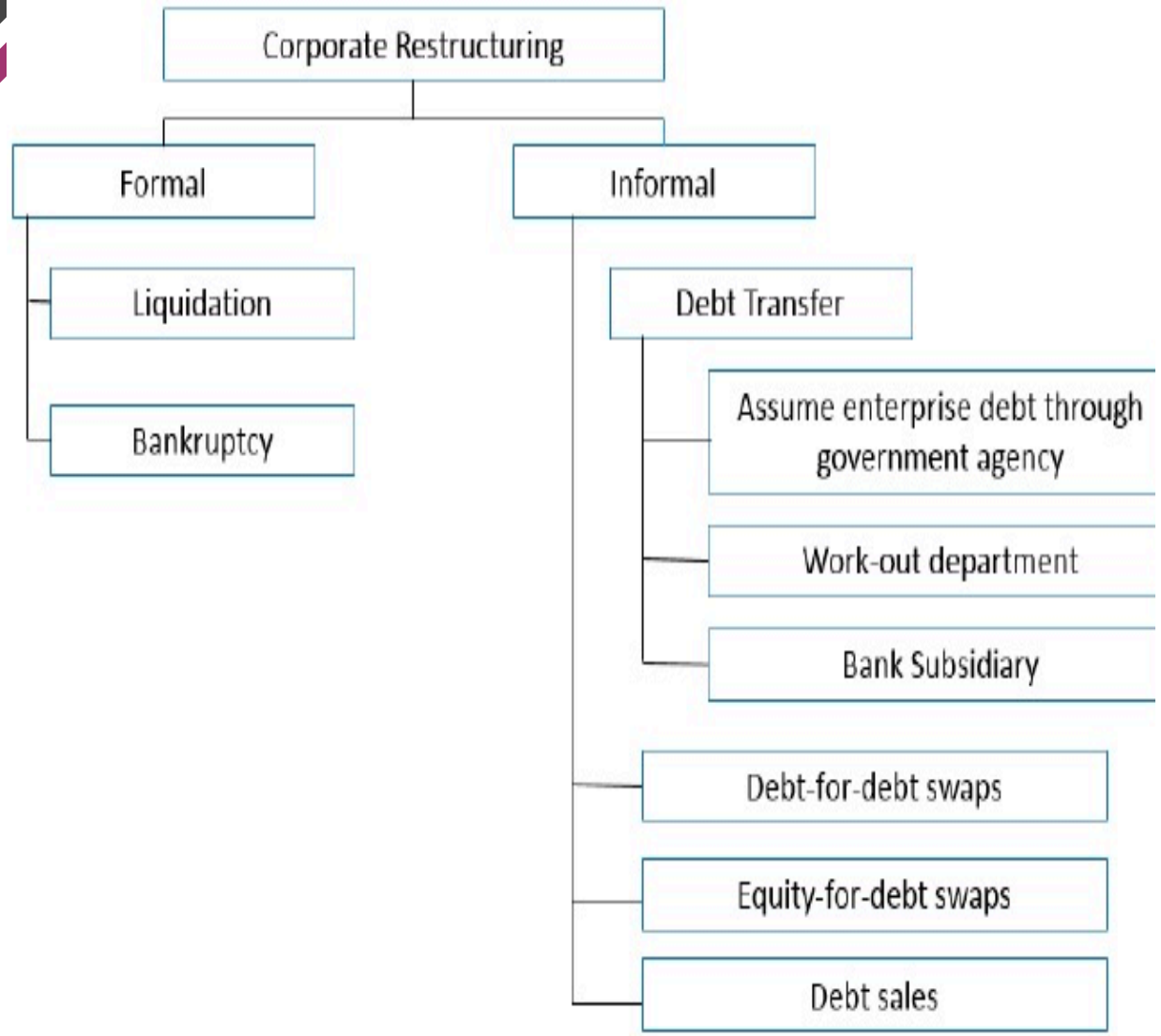
- Enhance **debt enforcement regimes** & insolvency frameworks
- Enhanced **prudential oversight** to incentivize banks to write off or restructure impaired loans
- **Resolution planning**
- **Consumer/investor protection regulations**
- **IFRS 9** & implications
- **Credit information systems**

Governance

- **Clarity in the structure of corporate ownership & control**
- **Board size & debt management; liability of Directors**
- **Risk Management & Audit Committees**
- **Improved transparency & disclosure**

Lessons from Global Corporate Restructurings

Approach to Corporate Debt Restructuring



Debt relief *has the largest growth impact for countries that exit restructurings with relatively low debt levels*

Impact on growth*: corporate restructuring periods are followed by positive real GDP growth with a lag but with negative short-term impact on employment and job creation*

Financial sector*: tighter lending conditions & rise in NPLs could cause banks' deleveraging*

Role of financial supervisors and government policy

- Swift, timely restructuring is crucial to remove uncertainty
- Risks/costs of government intervention – SoEs tend to incur higher debt costs
- Supportive fiscal policy: an unfavourable macro environment more difficult for creditor banks & corporates to resolve assets and reorganize business lines

Source: "Corporate Restructuring and Its Macro Effects", IMF Working Paper, Jan 2017

Lessons from Global Corporate Restructurings II

Banking soundness: banks' credit risk mgmnt has a profound effect on speed & degree of corporate restructuring

Legal & market infrastructure

- Clear guidelines and proper legal framework: reform of the insolvency & other related laws supporting out-of-court restructuring; financial deregulation also supports restructuring
- Market infrastructure. The transparent, reliable disclosure of firms' business and financial conditions, and the deepening of the financial markets play important roles in facilitating corporate restructuring
- Favorable tax treatment on debt restructuring or write-offs could lead creditors to write off more debt (when applicable)

Dimension of firm structuring

- A multi-faceted debt restructuring approach: lenders collaborating, bankruptcy process well-defined, general cost saving measures, disposing of non-core or non-performing assets to reduce bank debt…
- Business reorganization: e.g. narrowing their product focus and reducing their product cycle, corporates are able to restructure and attract investors
- Management's reliability and competency: having the "right" management

Setting **policy to strengthen banking supervision, improved corporate governance frameworks & fiscal supports during restructuring period are important** to mitigate potential negative spillovers on banking & employment

Source: "Corporate Restructuring and Its Macro Effects", IMF Working Paper, Jan 2017

Key Takeaways

- **Global debt has been building up**: growing risks to the financial system stemming from monetary policy normalisation & portfolio deleveraging/Quantitative Tightening. EMEs with shorter debt maturities, low reserves & fiscal scope to accommodate rising debt costs are highly vulnerable
- **The New Oil Normal led to higher debt levels in the MENA/GCC region**; but, GCC were supported by initially low public debt-to-GDP ratios & accumulated savings/buffers
- **Macroeconomic conditions are leading to challenging regional financing conditions**; NPLs relatively low with indications that loans with payment delays are being restructured
- **To break the Boom-Bust Cycle, GCC countries need to develop:**
  - **local currency, liquid, deep & active debt markets**
  - **Counter-cyclical fiscal policies & tools**;
  - Reform the **legal & regulatory framework** *(bankruptcy, insolvency, structured debt instruments)*; improve **corporate governance** *(better transparency & disclosure)*; credit information systems

Building Blocks For Effective Corporate Debt Management

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