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THE BUSINESS SCHOOL FOR FINANCIAL MARKETS

The Competitive Position of the Gulf as a Global Financial Centre

CITY OF LONDON

May 2008

THE BUSINESS SCHOOL
FOR FINANCIAL MARKETS

The Competitive Position of the Gulf as a Global Financial Centre

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Foreword

The Rt Hon The Lord Mayor of the City of London

Alderman David Lewis

As globalisation accelerates it is clear how important the Middle East is in the process, especially the member states of the Gulf Co-Operation Council (GCC). The surge in liquidity generated by high energy prices underpins the changes that are taking place, and the region will continue to control a major share of the world's increasingly scarce hydrocarbons. Yet the picture is far more complex than just an increase in capital and its velocity of circulation. This study demonstrates that there are radical changes underway in the way that the region generates and uses capital, and that mechanisms are developing to enable it to be deployed regionally and internationally, in search of short term profit and long term absolute returns.

There are long, established links between London and the Gulf. These are the links my predecessors and I celebrate when we lead business visits to the region, or warmly welcome guests here from GCC Royal families, businesses and governments. These visits reinforce the City's role as a hub for handling capital flows and deploying them efficiently around the globe, whether into portfolio investment, property, private equity or infrastructure finance. Against this backdrop, the development of London's capacity for Islamic Finance is a natural extension of the City's innovative leadership. Products which enable Muslims to engage with the international financial system in ways consistent with the Faith make practical, ethical and business sense. They also have more general appeal to the investor community.

London cannot however just rely on historical links. Other financial centres are seeking a larger share of Gulf business, and now regional financial centres are emerging features of the Gulf itself. We support the development of Dubai as a distinct and innovative 'offshore' centre; the growth of Qatar's capacity to handle and channel the huge capital flows generated from gas sales; the solid regulatory character and skill set of Bahrain; Saudi Arabia's intention to broaden its domestic capital markets; the massive financial resources available to Abu Dhabi and Kuwait; and the quiet but effective broadening of the Oman economy. At the same time, the Gulf's major family-owned trading groups are asserting themselves as international rather than regional players, and starting to consider opening up to outside ownership.

This study, commissioned by the City of London from the ICMA Centre at the University of Reading, analyses these developments, and the economic and political structures within which they are taking place. Its conclusions are mixed; the process of change in the Gulf is a dynamic one. Yet we can be sure that the GCC region, positioned between Europe and the Americas on one side and South and East Asia on the other (with transport, business and cultural links to

both), will be a critically important part of the world economy in the years ahead.

Whether one location emerges as the principal financial centre in the region remains to be seen. But whatever the outcome, London, as the leading global financial centre and a store of expertise, a centre for education and professional development, and a mechanism for channelling and harnessing capital, should remain closely engaged with all business centres in the Gulf region.

David Lewis
London
May 2008

Executive Summary

This report assesses the competitive position of the Gulf as a financial centre, its state of development and likely future developments. Linked to this is a growing interest in London in Islamic financial assets, with regard to which the Gulf region is likely to be a significant consumer and producer.

In recent years the Gulf States have felt a need to diversify their economies away from oil and gas. They are developing their financial sectors because they:

- see that financial services can offer an alternative source of revenue;
- need to mobilise money locally for local development;
- need to develop sophisticated techniques for funding large infrastructure developments;
- face a growing demand for Shariah-compliant financial structures.

The Gulf States have followed a number of paths to develop their financial sectors. Some have focused on developing their domestic markets and some, notably Dubai and Qatar, have focused on developing international markets.

Challenges for Gulf financial centres

The Gulf States face a number of challenges in developing their financial centres:

- Against international comparisons, their financial and business sectors have great scope for development. The GCC States are major capital exporters but the domestic quoted corporate sectors are small – reflecting major state shareholdings and the policies of the major family groups, for whom family ownership has until now remained the course of choice.
- Human capital and the lack of availability of appropriately skilled staff is a common weakness in developing financial centres. This is true in the Gulf States where the problem is compounded by large government sectors. There has been an extensive reliance on expatriate staff, which seems likely to continue. Fully-fledged development of financial sectors will, however, require greater involvement of the local workforce to occupy management positions in financial institutions. A specific area of skill deficit is in financially-trained Shariah scholars.
- The financial and business environment is crucial to the success of a financial centre. Gulf States score well on tax levels but perform less well on measures such as levels of government involvement, levels of corruption, and property rights. As business centres, Dubai, Qatar and Bahrain in particular are rated as attractive, suggesting that the creation of financial centres in Qatar and Dubai has enabled them to create a more conducive environment for their financial centres than the general business environment in the States.
- The Gulf region is home to about 60% of global sovereign wealth fund (SWF) assets and the funds are expected to grow rapidly. This is causing

the Gulf SWFs to expand their range of assets and change their investment style. The Gulf States tend not to be transparent in their investment behaviour, however, and may well need to adapt to changing international standards of disclosure.

- Private sector asset management has largely been channelling oil revenue funds into a narrow range of assets in Europe and the US. Underlying changes in the region mean that a broader range of assets and customers will need to be included for future development.
- The high levels of state or family ownership have meant that corporate governance practices have not developed in line with international standards. There are now signs that as the GCC States engage more closely with the global economy, there is growing awareness of the need for change and improvement.

Emerging financial centres

The local capital markets display a number of common features:

- with the exception of Saudi Arabia, all are small, relatively illiquid and volatile;
- regulation and corporate governance are often below international standards;
- markets are largely speculative and their illiquid character can unduly magnify price movements; and
- exchanges are owned and operated by the government.

The expectation is that the local markets, including Saudi Arabia, will develop to attract inward investment business but will maintain a largely domestic focus. Bahrain has been the regional banking centre, but its position appears to be challenged by the liberalisation and development of financial sectors in other states.

Dubai and Qatar have acted to overcome the restrictions of the small size of their domestic economies by opening international financial centres which have attracted major international players. Both centres have similarities but also important differences. In particular, Qatar may have advantages because of its need to mobilise capital for infrastructure and because of the greater integration with the domestic economy. Dubai has a track record of success in diversifying, however, and the motivation of fast declining income from oil sales.

Islamic finance

Islamic finance is experiencing very fast growth - current estimates suggest between 15% and 30% per annum – although it remains small compared with 'conventional' finance. Islamic issuers and markets have recognised the need for standardisation of products and certainty of interpretation. Recently the growing importance of international Islamic finance bodies and a number of international initiatives have made progress in developing standardised products which will accelerate Islamic finance's acceptance into the mainstream of capital markets. There is a lack of progress on risk management tools, however, particularly with regard to derivative contracts

Future Developments
Two recent developments affecting the GCC centres are noteworthy:

- The emergence of significant cross holding of UK and US exchanges by GCC partners (Dubai for NASDAQ and Qatar for LSE). This may mean that issues which are currently seen as competitive between exchanges will in fact become collaborative.
- The UK government's position that the UK should become a major portal for Islamic finance. Associated initiatives in equalising the tax treatment of Islamic financial instruments towards issuing a UK-government sukuk signal that the UK authorities see Islamic finance as an enduring part of the financial landscape.

These developments are likely to help secure the future of Islamic finance as a major element in the global financial system, and also help to ensure that international markets continue to play a full part in the supply and allocation of capital to the world's major investment institutions and corporate investors.

1 Introduction

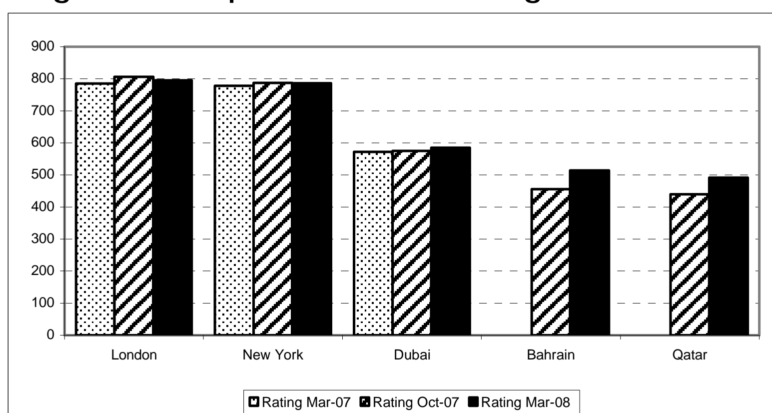
The City of London Corporation commissioned the ICMA Centre, University of Reading, to produce a research report on the growth of Gulf Cooperation Council (GCC[1]) financial markets and to make an assessment, based on the information available, of:

- their growth;
- their relative position and their likelihood of success;
- the impact of the growth of Islamic finance on these markets;
- the effect of this growth on markets such as London's, which have traditionally offered a marketplace for capital from the region.

The Gulf has long been a region of great wealth based on revenues from its oil and gas reserves. Historically that wealth has been recycled through the global financial centres into investments in Europe and the US. In recent years, the rising price of energy has increased the inflows and the wealth of the region – for example, current estimates suggest that sovereign wealth funds totalled £800bn by the start of 2007 and that private wealth is of even greater magnitude. At the same time, the Gulf region has been expanding its demands for capital to develop infrastructure and finance economic diversification. This process has involved the development of a number of financial centres in the region - where previously all financial services were imported.

Figure 1 shows the rating given to three of the GCC markets in the last three Global Financial Centres Index publications[2]. This shows that Dubai is well established with a consistently high rating, most recently ranked in 24th place in GFCI 3. In contrast, both Bahrain and Qatar are improving their ratings (39th and 47th respectively in GFCI 3), showing the largest increase in score from GFCI 2 to GFCI 3 of any of the financial centres considered.

Figure 1: Comparison of GFCI Ratings Over Time for Gulf Financial Centres



Source: Global Financial Centres Index 1(March 2007), 2 (September 2007) and 3 (March 2008)

[1] The GCC countries are Saudi Arabia, Qatar, Oman, United Arab Emirates (UAE), Bahrain and Kuwait.

[2] *Global Financial Centres Index*, City of London Corporation, March 2007, October 2007, March 2008

It should be noted that the project was not designed to investigate Islamic finance *per se* and it was not intended to compare the relative success of the two major Islamic centres – in the GCC and Far East (principally Malaysia).

The structure of the report is as follows:

- Chapter 2 outlines the research design and method used in the study.
- Chapter 3 provides background on the GCC region and the place of financial markets in its economic development.
- Chapter 4 discusses the structure and prospects of each of the major GCC financial markets in some detail.
- Chapters 5 and 6 discuss specific issues relating to the future development of Islamic financial markets, and issues regarding corporate governance in the region.
- Chapter 7 focuses on London and the steps it is taking to establish itself as the global centre for wholesale Islamic products. This chapter also summarises recent developments in market cooperation between the London Stock Exchange (LSE) and GCC markets.
- Finally, Chapter 8 reviews the findings of the research and highlights key emerging messages and policy implications.

2 Project design

The research undertaken for this project was divided into two parts: desk research, and interviews.

2.1 Desk Research

This part of the research was designed to:

- provide the background to the GCC and statistical material on each of the significant markets;
- summarise the position in regard to Islamic finance and corporate governance;
- identify key issues for discussion and elaboration in the interviews; and
- summarise developments in London's moves towards Islamic finance and co-operation with Gulf financial markets.

This was intended to extend our understanding of:

- the structure and nature of the various Gulf financial centres, including questions relating to the level of government involvement in capital market development, and the local companies that might use those capital markets and attract international interest;
- the actual level of development of the Gulf financial centres, including the identification of key differences between them. This would include, for example, identifying those that were likely to remain as local markets and those that might develop into centres attracting considerable international business;
- the awareness of, interest in, and level of acceptance of, international capital market norms, such as those relating to corporate governance and economic freedom;
- the resource endowments of the individual Gulf countries insofar as these might affect their motivation and commitment to development of financial centres; and
- the nature of the debate surrounding Islamic finance as well as past development and likely future growth in this area.

The research made extensive use of a wide range of information sources including:

- websites and publications issued by Gulf entities, such as central banks, stock exchanges, and regulators;
- websites of international organisations including the Bank for International Settlements (BIS), the World Federation of Exchanges (WFE), the World Bank (WB) and the International Organization of Securities Commissions (IOSCO);
- websites of international and local research associations – such as the Institute for International Finance (IIF) and Hawkamah Institute for Corporate Governance;

- publications of various organisations involved in Islamic finance including the International Islamic Financial Market Institute (IIFMI), the Bahrain Institute for Banking and Finance (BIBF) as well as non-Gulf organisations with an interest in Islamic finance such as IOSCO and International Financial Services London (IFSL);
- news services and current affairs publications - both international and local to the Gulf.

2.2 Interviews

To complement the desk research, a series of semi-structured interviews were also conducted. The principal purposes of the interviews were:

- to discover whether new issues or factors not identified in the desk research have arisen (for example, new issues in Islamic financial provision);
- to discover participants' views on the development of GCC markets, the degree of competition perceived between those markets, and the relative importance of Islamic and 'conventional' sources of finance;
- to discuss participants' views on the future prospects for GCC-based financial markets.

An informal set of questions and areas to be discussed were developed in advance of the interviews. These questions included general questions on economic development as well as those relating to the main focus of this research. It was agreed that all questions should be addressed to all interviewees, accepting that each would probably wish to focus on one or other set of concerns. The set of 'discussion topics' included:

- General
  - an invitation to comment on the state of that country's capital markets (except in the case of UK interviews);
  - an invitation to comment on the international financial markets;
  - the effect of the different size and wealth of Saudi Arabia compared with any other GCC country.
- Market Development
  - the development of the country's markets over the last five years;
  - projected development over the next five years;
  - the positioning of this market compared with others in the region;
  - the size and significance of the market.
- Human Capital
  - the availability of appropriate skills;
  - language issues (both for regulators and participants);
  - the use of 'foreign' labour, currently and in the future.
- Corporate Governance
  - the governance situation in the country;
  - the effectiveness of various initiatives to impose common Corporate Governance standards across the region.
- Islamic Finance
  - its recent growth;
  - its long term status in the region;
  - its impact internationally.

- London
  - the current attractiveness of London as a Global Financial Centre (GFC);
  - the effect of London's announcements with regard to Islamic finance;
  - the impact of the various alliances between GCC securities markets and their counterparts in London and New York.

Where possible, we stayed away from matters peripheral to the specific project brief, and so we did not discuss the general economic development of the region or the politics behind some local and international concerns. While these are interesting topics, they lie outside the scope of the present project.

The interviewees were selected so as to:

- obtain the views of a representative group of interests from the region overall;
- ensure a reasonably balanced set of interviewees from each country.

All of the representatives were of senior status within their organisations and influential in the markets concerned, and all had sufficient experience and authority both to represent the views of their organisation and to offer views that were based on their own experience.

Table 1 shows the distribution of institutions and firms that people were interviewed from. In total, 41 individuals participated in the discussions. All interviewees were senior representatives of their organisations, and all were in a position to offer specific views on the development of Gulf financial centres.

Table 1: Nationality and Nature of Institution

Country	Policy Maker	Market Regulator	Islamic Agency	Market Participant	Total
Dubai	4	2		3	9
Qatar	1	2		2	5
Bahrain	2	1	3	1	7
London	1		1	1	3
Saudi Arabia[3]	1	3		2	6

The interviews lasted between 45 and 90 minutes and took place in the interviewees' offices in the relevant country. In addition, we had informal discussions with experts from non-GCC countries to obtain a broader perspective on the status of GCC markets and the future role of Islamic finance.

In common with much other research of this type, interviews were conducted confidentially to ensure that the respondents expressed themselves as frankly and fully as possible. In keeping with this, we did not record the discussions or

[3] Because of the well-known problems in obtaining visas for short visits to Saudi Arabia, the interviews for Saudi Arabia were conducted by telephone and were, therefore more brief than was the case for the other countries.

keep a verbatim record, although handwritten notes were taken. Interviewees understood that their views would not be reported directly but would be used to inform the researchers' own arguments. To this end, we do not attribute views in the report, nor do we make use of direct quotes, which could lead to the identification of the interviewee concerned.

While we report a consensus view of the interviewees and do not attribute opinion to any individual, it was striking that most interviewees (whether regulators or participants, and from whichever country they operated in) gave remarkably consistent views on most of the issues above. There were, not surprisingly, quite different views on the indirect question of how the GCC markets would fare against each other and which ones would be successful. By and large, respondents tended to be confident of the success of their own financial centre and, though natural politeness constrained their comments on competing centres, were equally confident that others would be less successful. The focus of the research was on the factual information and so, while the supporting evidence is reported, the expressions of local confidence are not.

3 Background to Gulf Financial Development

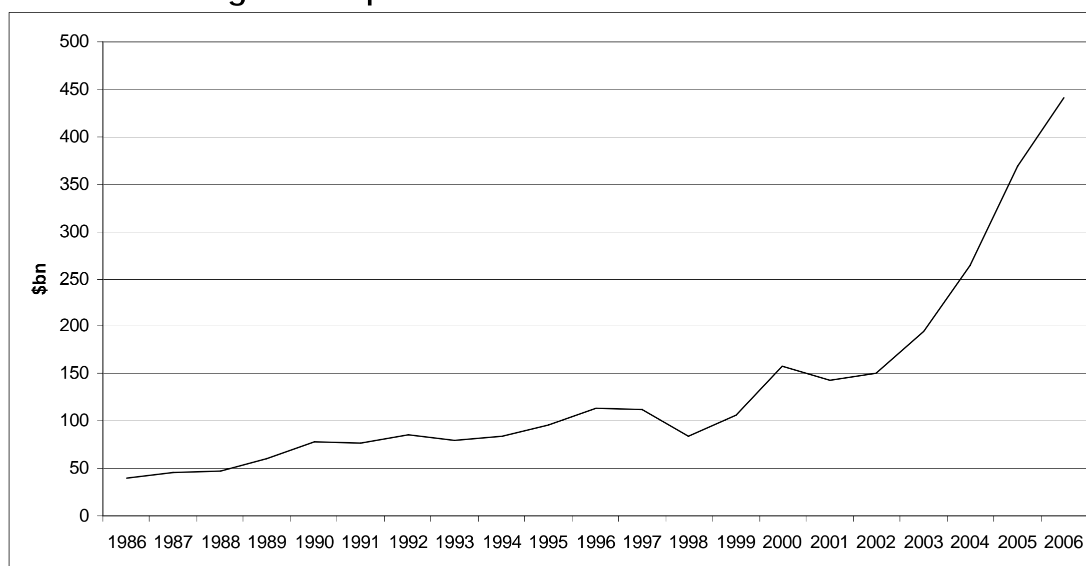
This chapter examines a number of issues that provide background to the development of Gulf financial centres:

- the motivation for developing financial centres;
- the human capital issues raised by that development;
- the financial environment in the GCC states;
- the wealth and asset management situation.

3.1 GCC Development

Traditionally the GCC countries have relied upon oil and gas revenues. These have been increasing over the long term and most recently as demand pressures have driven up prices. Figure 2 shows the export revenues of the GCC OPEC members (Bahrain and OPEC are not members of OPEC, but in any case export little oil). As the data shows, revenues have risen steeply since 2002 to reach $440bn in 2006 – and no doubt substantially more in 2007.

Figure 2: Export revenues of GCC OPEC members



Source: OPEC Annual Report 2007

Of course the endowment of natural resources has not been even and some of the Gulf States, notably Bahrain and Dubai, are approaching the end of their reserves. The other five states have ample supplies. Table 2 shows the figures for production, reserves and time to exhaustion for the major exporters.

Table 2: Oil and gas reserves of major GCC exporters

	Oil			Gas		
	Production	Reserves	Years at 2006 prodn level	Production (gross)	Reserves	Years at 2006 prodn level
	000 bpd	m bls		m cu m	bn cu m	
Saudi	9,208	264,251	79	85,001	7,154	84
Qatar	803	15,207	52	60,960	26,636	437
Kuwait	2,685	101,500	104	13,670	1,572	115
UAE	2,568	97,800	104	69,660	6,040	87
UAE prod of oil 2006 '000 bpd						
Abu Dhabi	2,478.3					
Dubai	89.7					
	2568					

Source: OPEC Annual Report 2007

This data indicates that Saudi Arabia, Abu Dhabi, Qatar and Kuwait have reserves of oil and gas that will last into the foreseeable future.

Even those states that have large reserves have seen a need to diversify their economies, however. In some cases, particularly Saudi Arabia, the aim is to provide employment for a rapidly growing population. In others, such as Qatar, a diversification into financial services is driven by a desire for the country to have an efficient financial market for allocating its large, planned infrastructure expenditure.

In addition, Gulf countries have become concerned about their reliance on the US and Europe for the financial services needed to manage the investment flows resulting from their oil/gas surpluses. The Gulf area has long been a source of capital, but in recent years the states in the region have set about developing financial centres of their own. There seem to be several separate reasons for encouraging financial centre development:

- the belief that financial services offer an alternative source of revenue in the future – this implies that the services will attract international interest;
- a desire to develop industry and infrastructure in the local economy by mobilising domestically raised finance rather than exporting the capital and then re-importing it;
- a need to develop infrastructure within the states by mobilising local and international resources using sophisticated financial techniques to fund the projects and remit the revenues;
- a growing desire to increase the use of Shariah-compliant financial structures.

The relative importance of these as a motivating factor varies from state to state; this has led to a diversity of development which is described later in this report.

We have already noted that the Gulf States differ substantially in their natural resource endowments. They also differ in other ways for example:

- some have better developed democratic structures;
- some have a higher degree of economic diversification;
- some are more open to the outside world;
- some have federal structures of government.

All are highly jealous of their independence. So, while this report speaks of the Gulf States, it should be remembered that the similarities are great but that the differences are also important.

The differences are especially important in the development of financial centres. For example, openness to the outside world is generally recognised as crucial to the success of financial centres as it enables a centre to attract foreign business, international participants and expatriate skilled staff. Equally, a stricter interpretation of Islamic precepts could restrict the development of a financial centre – although, in practice, all the Gulf States have permitted "conventional" financial operations to run alongside Islamic structures.

It is particularly noticeable that the Gulf financial sectors have tended to follow a different route to that of other developing markets. In the Gulf region, the general approach has been for the government to set up and own the capital market infrastructures. Our understanding from research and interviews is that this development path means that the government connections remain stronger and more influential than in other developing markets (most of the stock exchanges are government owned and controlled, for example, which is increasingly unusual outside this region). This presents opportunities (it is easier to get things decided, for example) but also specific challenges (for example, it can make innovation harder). The cultural differences have also led to a particular style of transacting business, with more emphasis on personal relationships than is true of some markets – although one that is very important in the UK market. The different levels of development described in Chapter 4 reflect varying perceptions of market openness, state involvement, and the role of Islamic ethics.

Historically the centres have grown out of large capital inflows. First there was a need to invest the inflows profitably, followed by the need to convert the cash flows into sums for infrastructure projects and finally the need to diversify their economies. They have lacked and continue to lack the portfolio investment opportunities that have driven financial sector growth in other developing markets, however, because of:

- the lack of development of the non-oil sectors;
- the preponderance of government owned companies in infrastructure;
- the predominance of family-owned companies.

The structure of corporate ownership in the GCC countries is such that there are few major companies in which international investors can build up economic stakes. For a variety of reasons, state or family ownership is more common than

flotations on regional or global markets. The development of a bigger quoted sector is both likely, and a necessary part of building up financial centres with international depth and liquidity.

Recent high volatility – the Gulf markets in 2006 endured a substantial slump in values – and regulation (especially disclosure/corporate governance) have also deterred the more conventional international investors. Hedge funds have entered the market – since the high level of risk is exactly what they want. However hedge fund money is by definition mobile, and a developed and liquid financial centre requires a balance of stable and mobile funds to prosper.

The Gulf markets have many of the characteristics of transitional markets (such as those in Eastern Europe) since they have to some extent been 'semi-detached' from the global financial markets (except as suppliers of capital) and have high levels of government involvement in their financial sectors. At the same time they display characteristics of developing markets, in that they are trying to integrate western-style financial regulation into systems where, for understandable reasons, concepts in areas like corporate governance are very different.

3.2 Human capital

Populations in the Gulf States are expanding rapidly – for example the population of Saudi Arabia, the largest in the region, has risen from 7m in 1974, to 16.9m in 1992, and 23.6m in 2006. Many, however, still have small citizen populations supplemented by resident expatriates. Kuwait for example has a total population of 3.4m, but the number of Kuwaiti citizens is approximately 1m (there are no exact figures). While there is a need to provide employment for these growing populations, the spectrum of skills required for financial centres is less easily available.

Human capital is always a problem for new markets – especially in the regulatory field. Bahrain makes the claim to have the strongest human capital resources, because of its long history as an offshore banking centre and the number of training institutes located in the country. Dubai, and to a lesser extent Qatar, have addressed the shortage by bringing in experts from overseas. The UAE generally, and Dubai in particular, have very high proportions of expatriate workers – estimates generally suggest over 80% and some over 90%. Dubai has a policy of "Emiritisation" of its banks and Qatar has similar policies, but these do not appear to be being pressed with much determination. In general, Dubai and Qatar seem happy to continue to have a very large expatriate population and there does not seem to be a shortage of those wiling to come. A reduced willingness to use expatriates, combined with specific skills deficits among local workers in other Gulf States, means that we would anticipate more severe human resources problems in the other states.

There is a particular weakness with respect to availability of skilled staff – for firms and regulatory bodies. Much, though not all, education in the region does not provide the necessary skill set, especially with regard to finance and economics, as well as being somewhat inflexible with regard to teaching methods. Many of the more affluent are educated abroad but there is a chronic shortage of more junior staff to perform the regular tasks in financial institutions. It is also the case

that in many states there is a culture of pseudo-employment in government agencies, where duties are sometimes light but salaries are high. The problem is exacerbated by shortages of local financial training schemes and shortage of financial training resources.

In other developing markets the salary policies of regulators is a barrier to the recruitment and especially the retention of able staff. It is common in all markets for regulators to face difficulties competing with other parts of the financial market. One way or another, regulators' salaries are usually tied to civil service rates. In many developed markets, regulators have developed personnel policies that assume a high level of turnover among younger staff, and see themselves as an entry point for the industry. In the Gulf region this issue is less pressing as government salaries are usually highly competitive with private sector salaries. Work in financial regulation is often more demanding in terms of hours than work in other areas of government, however, as well as being perceived as of lower status - so Gulf regulators still find it difficult to attract and retain staff.

A key shortage which appears to be a barrier to the even more rapid expansion of Islamic finance is the lack of sufficient Shariah scholars with financial expertise to meet the growing demand for Shariah-compliant financial products.

3.3 Competitive environment of Gulf centres

The basic competitive environment of a financial centre is recognised as being crucial to success. Environment in this sense encompasses a wide range of features including physical infrastructure, but also looking beyond that to encompass legal structures, business freedoms, tax structures and the role of government.

Developing the right competitive environment is critical for financial centres, yet can be very difficult to deliberately bring into being. This is, in part, because it is hard to come to single simplistic definition of what precisely comprises the right environment, not least because of the many contributing and interlocking factors. Even if it were possible to theoretically define an ideal financially competitive environment, this would not be easily to practically implement, because any changes made to support a financial centre would have sweeping implications elsewhere in the economy. For example, a successful financial centre needs to have clear laws to govern insolvency and supporting institutions to enforce those laws. But insolvency also affects the survival of firms in the rest of the economy and may have implications for employment and social policy, for example. Many developing markets have struggled to develop workable bankruptcy codes for just such reasons.

The historical development of a financial centre also plays a part – big centres today have tended to be big centres in the past; the emergence of Shanghai and Mumbai shows that historical trends are not immutable however. Finally there is an element of "winner takes all" – truly global financial centres are not just marginally more successful than others, they are substantially more so.

The Gulf States have certain advantages in creating the right financial environment – they have ample liquidity and they mainly have small populations to be employed. At the same time those factors mean they have little in the

way of historic foundations or local demand to support financial centre development.

In these sections we present the results of two pieces of research comparing the financial environment across countries. The first is the Global Financial Centres Index (GFCI), produced for the City of London Corporation and previously discussed here. The GFCI has to date been published three times[4]. This is a broad assessment of competitiveness, covering five aspects:

- People: This relates to human capital, with regard to the availability of skilled personnel, levels of business education, and the flexibility of the labour market. These can be issues of concern for emerging economies, as has been discussed here.
- Business environment: This relates to aspects such as regulation, tax rates, levels of corruption, economic freedom and the ease of doing business.
- Market access: This covers the volume and value of trading in equities and bonds, and levels of securitisation, as well as aspects such as clustering effects. These are discussed in more detail for the Gulf financial centres in Chapter 4 of this report.
- Infrastructure: This is primarily concerned with the cost and availability of buildings and office space, although also considers infrastructure factors such as transport.
- General Competitiveness: This considers more general economic factors, including price levels, economic sentiment, and perceptions of the quality of life in these centres.

The second piece of work focuses more on economic liberalism or freedom. The Index of Economic Freedom (IEF) [5], produced by the Heritage Foundation and the Wall Street Journal, takes a more detailed look at the aspects considered in the GFCI under Business Environment. Specifically it looks at:

- the degree of government involvement in the economy;
- the restrictiveness of laws on company formations, investment, labour, and the like;
- the effectiveness of regulation and property protection;
- taxation;
- corruption.

3.3.1 The GFCI

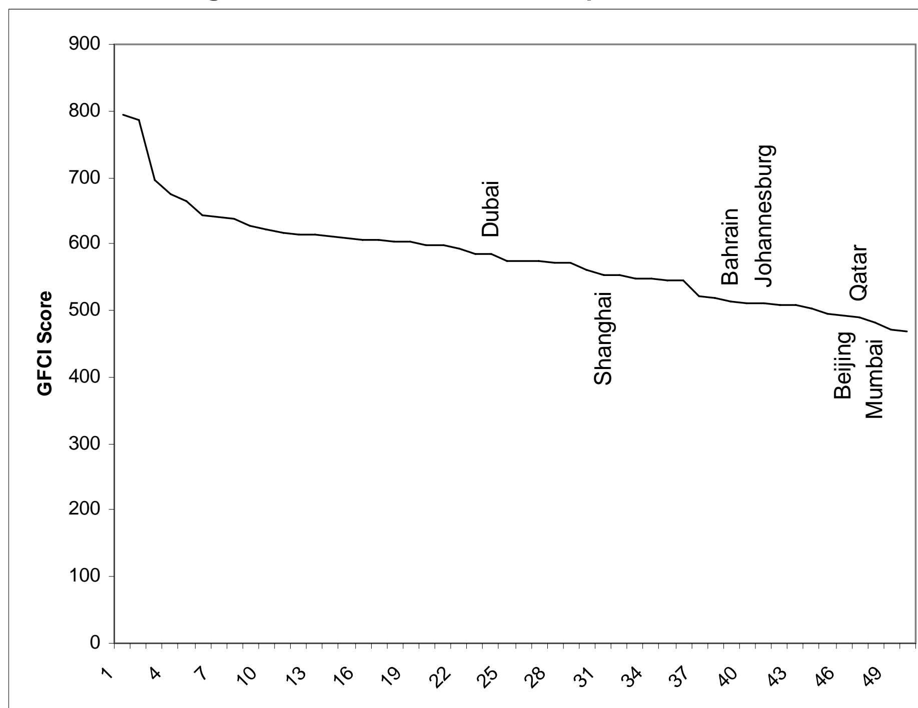
The GFCI analysis produces a ranking of the top 50 financial centres, using a combination of data from external indices and questionnaire responses from financial services professionals. Interestingly, only three of the Gulf financial centres – Dubai, Qatar and Bahrain – are included in the analysis. The top end of the GFCI rankings is dominated by long-established centres in developed countries (including London, New York, Hong Kong and Singapore), and the well-established offshore centres. We have focused on the position of the Gulf centres in relation to that of the financial centres that they are most closely

[4] The Global financial Centres Index 1 (March 2007), 2 (September 2007), 3 (March 2008) Z/Yen Group Limited, for the City of London Corporation.

[5] Index of Economic Freedom 2007 – Heritage Foundation/Wall Street Journal.

comparable with. Figure 3 shows the range of GFCI 3 scores for all the 50 centres in descending order, with the three Gulf markets and some of their developing market comparators indicated.

Figure 3: GFCI 3 scores for top 50 centres



Source: GFCI 3 (March, 2008)
Note: High scores indicate greater competitive advantage

Relatively few developing markets are included in the top 50 – just seven including the three Gulf centres. Dubai ranks 24th in the overall ranking, making it the highest placed centre from the developing market group. The next highest is Shanghai ranking 31st. Qatar and Bahrain receive rankings comparable with Mumbai and Beijing.

The GFCI analysis also classifies centres according to their sensitivity to instrumental factors and variance of questionnaire-based centre assessments. These respectively look at how well a centre scores across all five aspects of competitiveness and to what extent the questionnaire ratings of that centre concur. Centres with higher degrees of either have much potential to rise or fall in the ranking in future. All three Gulf centres display a relatively high degree of both sensitivity and variance, indicating that their current rating is not very stable and has the potential to improve – or decline – rapidly.

It is worth noting that Dubai was also highlighted by questionnaire respondents as a centre likely to increase in importance, coming top in response to questions as to which financial centre might become significantly more important and where organisations may open new operations in the next 2/3 years.

3.3.2 The Index of Economic Freedom

Table 3 shows the scores for the GCC countries and the four major global centres. It also shows the scores for a number countries that are hosts to

financial centres and that have, at various times, been mentioned as possible centres for Middle Eastern finance – Lebanon (which clearly has separate, current problems but has been a contender), Istanbul, Cairo and India[6].

Table 3: Index of Economic Freedom 2007

Index of Economic freedom	Rank	Overall score	Region	Business	Trade	Fiscal	Freedom	Monetary	Invstmnt	Financial	Property rights	Corruption	Labour
GULF													
Bahrain	39	68.4	2	80.0	69.6	99.6	56.7	80.1	50.0	90.0	60.0	58.0	40.0
Kuwait	57	63.7	5	67.9	72.2	99.9	39.2	78.8	50.0	50.0	50.0	47.0	81.7
Oman	54	63.9	4	63.6	73.8	99.0	37.7	79.1	50.0	50.0	50.0	63.0	73.2
Qatar	72	60.7	7	60.0	71.4	99.9	54.6	72.4	30.0	50.0	50.0	59.0	60.0
Saudi Arabia	85	59.1	10	52.9	65.4	99.6	46.1	80.1	30.0	40.0	50.0	34.0	92.9
UAE	74	64.4	8	49.2	70.0	99.9	60.3	75.3	30.0	40.0	40.0	62.0	77.2
GLOBAL CENTRES													
Hong Kong	1	89.3	1	88.3	80.0	95.3	91.6	91.1	90.0	90.0	90.0	83.0	93.6
Singapore	2	85.7	2	94.6	80.0	93.0	86.2	89.5	80.0	50.0	90.0	94.0	99.3
US	4	82.0	1	94.5	76.6	79.4	67.5	83.8	80.0	80.0	90.0	76.0	92.1
UK	6	81.6	1	92.1	76.6	74.6	54.2	79.3	90.0	90.0	90.0	86.0	82.7
OTHER MIDDLE EAST CENTRES													
India	104	55.6	19	49.6	51.2	84.8	89.0	77.2	40.0	30.0	50.0	29.0	55.1
Egypt	127	53.2	13	39.9	52.2	93.6	73.6	69.0	50.0	30.0	40.0	34.0	49.8
Lebanon	77	60.3	9	56.2	67.4	95.9	64.3	83.5	30.0	70.0	30.0	31.0	74.4
Turkey *	83	59.3	34	67.4	76.0	79.4	69.9	70.2	50.0	50.0	50.0	35.0	45.4
* Turkey's regional ranking compares it to Europe rather than Middle East													
Its Middle East ranking would be just above Saudi Arabia - 9th													

Source: Index of Economic Freedom 2007

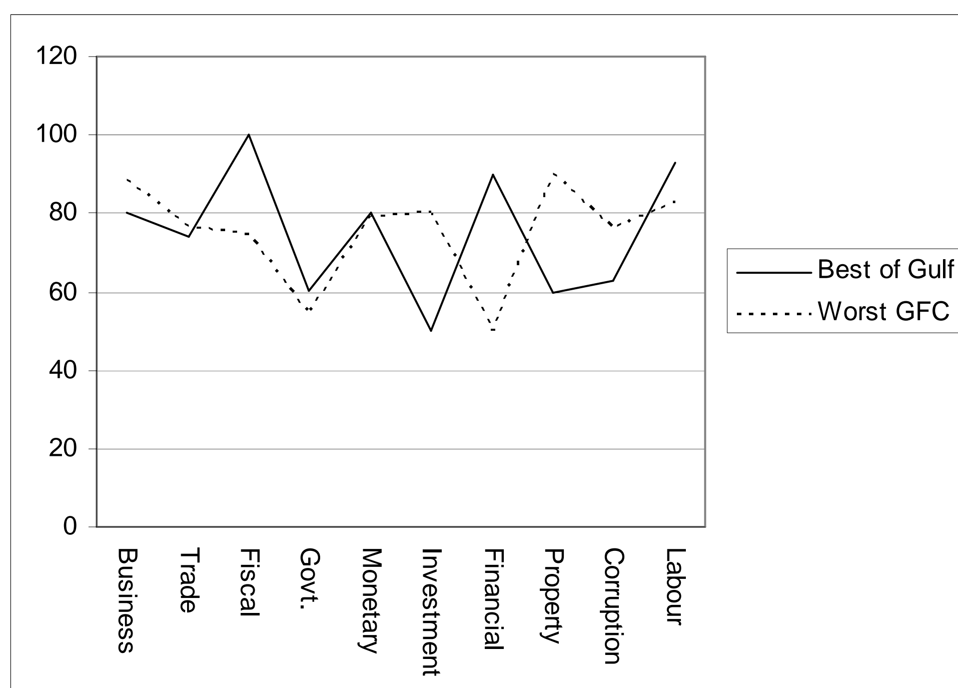
The first thing that is obvious from the table is that the Gulf countries have significantly more restrictive economic structures than the GFCs do. Even the Gulf centre which rates as the most liberal economy, Bahrain (rated as the second most economically liberal country in the Middle East – Israel is the first), is rated lower than all the global centres in every aspect apart from taxation (Bahrain has no taxes apart from those on oil companies).

Other potential Middle Eastern financial centres score less well than the Gulf countries, although the differences are smaller than those between the Gulf and the GFCs. Gulf centres rated stronger than other possible Middle Eastern centres in most areas, although less strongly with regard to government because of the large public sectors in Gulf States which do not exist in the other contenders to the same extent.

6 India has recently published a report on the prospects of Mumbai becoming an international financial centre – with special focus on its potential in south Asia and the Middle East.

Even comparing a composite of scores from the Gulf states, by taking the highest score achieved by any GCC country in each assessed feature (Best of Gulf in Figure 4 below) and a composite of scores from global financial centres (GFC), by taking the lowest score (Worst GFC) achieved by any of the Global Financial Centres for each assessed feature, shows areas of current weaknesses, as well as strengths, in the Gulf countries.

Figure 4: Comparison of Composite Scores for 'Best' GCC with 'Worst' Global Financial Centre

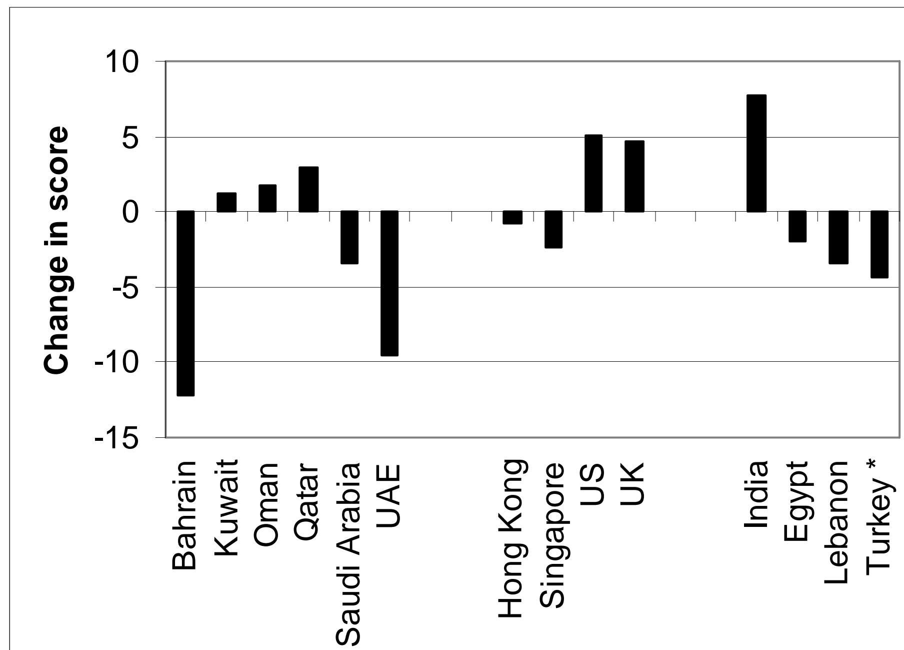


Source: Index of Economic Freedom 2007

This comparison highlights the strengths and weaknesses of Gulf centres. Gulf centres rate highly with regard to fiscal freedom, mainly because of their low tax rates. The apparent Gulf strength in financial freedom is largely a reflection of the very low score for Singapore. Other GFCs had roughly similar scores to the best of the Gulf scores. As shown, Gulf States score least well in freedoms relating to setting up of businesses, investment freedom, property rights and freedom from corruption.

Tracking these scores over time shows an apparent decline in economic freedom in three of the six centres, which is especially marked for Bahrain and the UAE, as shown in Figure 5. The results for Bahrain are affected by significant declines in business and investment freedom, property rights and freedom from corruption (partially offset by gains in financial freedom). UAE saw declines in scores for business freedom, government involvement, property rights and corruption.

Figure 5: Changes in economic freedom 1997-2007



Source: Index of Economic Freedom 2008

Kuwait, Oman and Qatar have seen some improvements in economic freedom since 1997. Over the same period, however, the UK and US have improved their economic freedom ratings and, by implication, their competitiveness as financial centres. India, sometimes perceived as a centre which might be challenged by the Gulf centres, has also shown a marked improvement, reflecting the rapid reform period which has been in progress since the early 1990s.

3.4 Asset management

A key impact of the change in the Gulf relates to how the wealth derived from energy exports will be managed and invested. This covers two aspects – sovereign funds and private individuals (although the distinction in the Gulf is less clear cut than elsewhere).

3.4.1 Sovereign funds

The sovereign wealth funds (SWFs) of the Gulf States are among the largest in the world. Combining estimates from several sources suggests that the GCC SWFs represent about 60% of the total of $2.5trn held globally in SWFs (end of 2006).

The GCC do not rate well with regard to transparency. Standard Chartered rates all the GCC funds as "low transparency", though those of the UAE and Qatar score slightly better than other Gulf SWFs[7]. Table 4 shows estimates of the GCC national funds at the end of 2006 (since when they have certainly risen substantially).

[7] Wealth of Nations – Caroline Allen, Standard Chartered Bank in Quantum, January 2008.

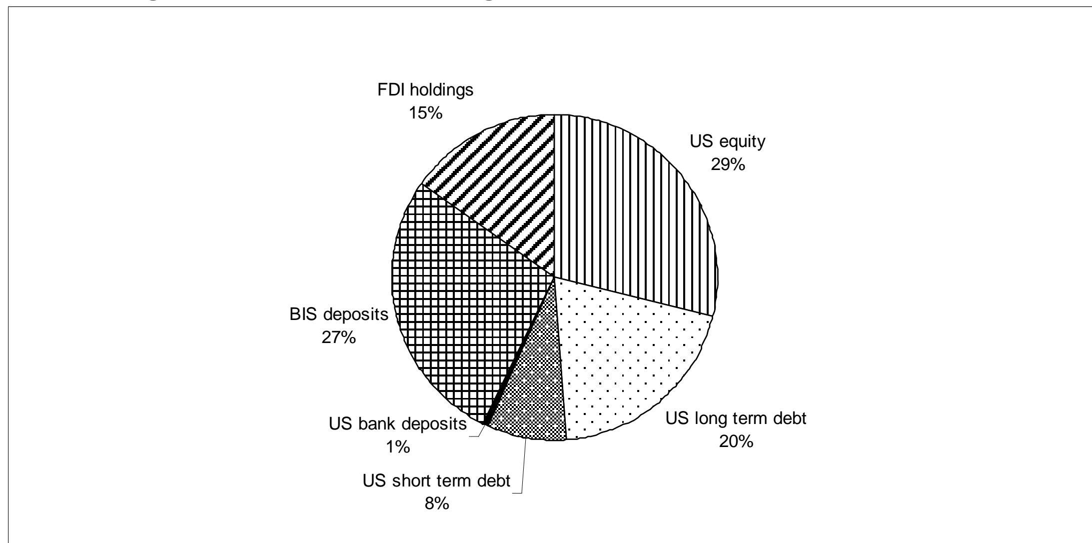
Table 4 Sovereign Wealth funds of GCC states[8]

GCC		
	$bn end 2006	£bn end 2006
UAE	600	306
Saudi	450	230
Kuwait	400	204
Qatar	70	36
Bahrain	20	10
Oman	10	5
Total	1,550	791

Source: Institute for International Finance, 2007

The lack of transparency means that little hard evidence exists as to the investment portfolios of the GCC SWFs – except when an acquisition makes the headlines, as the Dubai Ports attempt to buy P&O's US ports did. The International Institute for Finance (IIF) has produced estimates of the destination of Gulf capital outflows[9], shown in Figure 6. The heavy US orientation, at least in the identifiable part, is indicated by the allocation of $434bn (of the total of $1,550bn).

Figure 6: Identifiable foreign assets of GCC states at end 2006



Source: IIF, 2007

As shown in Figure 7, the IIF estimates for identifiable outflows confirm the geographic bias, with the US taking 56% of the identified outflows. Other commentators suggest that this represents a shift away from US investments,

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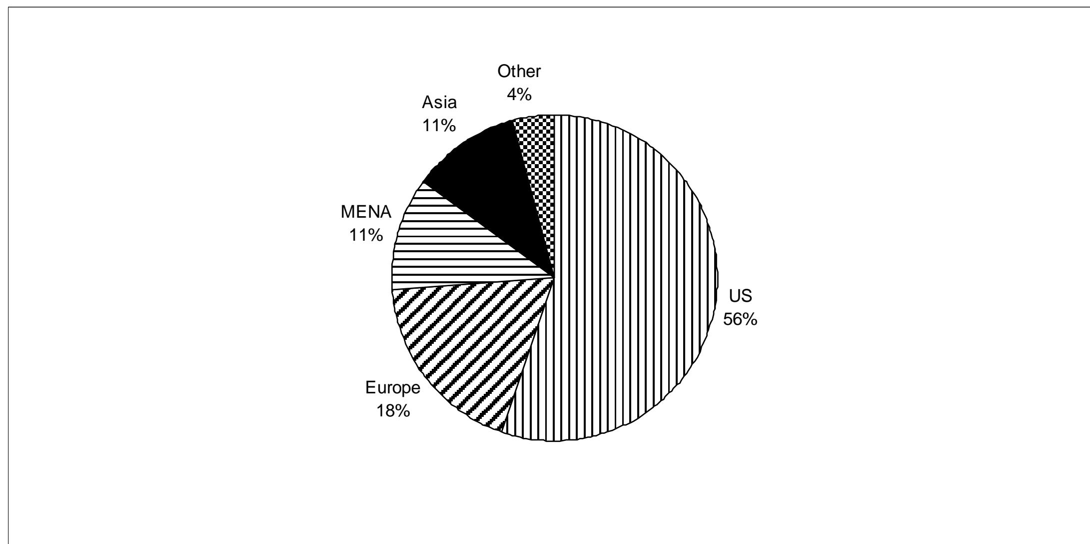
[8] Estimates from Standard Chartered give a higher value for UAE of $639bn of which they estimate $625bn (98%) is held by Abu Dhabi with the balance being in the SWFs of Dubai.

[9] Tracking the GCC petrodollars: how and where they are being invested around the world. Institute for International Finance (May 2007)

however, noting the 18% going to Europe, and 11% each to MENA countries and Asia.

Figure 7: Identifiable foreign outflows of GCC states at end 2006



Source: IIF, 2007

3.4.2 Wealthy individuals

The World Wealth Survey of 2007 estimated that private wealth in the region was equivalent to $1.4trn. This is relatively modest when compared to developed markets; to add some size context, UK pension funds had assets valued at over $3trn at the end of 2006 and Calpers, the world's largest fund, had assets of $260bn. It is, however, a sizeable amount

Traditionally these funds have been invested through and managed by private banks in Europe. In recent years a number of factors have changed this picture:

- the volume of funds has grown as oil prices have risen;
- there has been some repatriation of funds – in response to political pressures in the US, a growing desire for Islamic investments, and to the emergence, gradually, of regional investment vehicles;
- there is at least the beginning of a wider dispersion of wealth in the Gulf – leading to a growing demand for retail asset management vehicles.

This raises two questions that are important to asset management firms:

- To what extent will the repatriation continue and how will it affect the traditional destinations?
- Will a local fund management industry emerge to replace the current routes for investment?

The asset base in the Gulf region has increased, but the speculative bubble in the stock markets (which ended in 2006), and the threat of a similar bubble in real estate, all suggest that the available assets may not be sufficient to absorb

more than a fraction of the investable funds. This is aside from the concentration risks of having too much in a region with the potential for political and strategic instability. Total stock market capitalisation of the GCC countries is still small – £376billion at the end of 2006 - and much of that capitalisation is not available to investors (government stakes, family holdings, for example). We do not have estimates of the value of real estate in the region, though the recent rises in price suggest it is an illiquid market. We note that some of the proposals to establish financial centres are based largely on the real estate gains that are expected to accrue.

Traditionally, Gulf investors have had a significant focus on real estate – especially in the UK and Germany. There is relatively little investment in European, or indeed global, equities (the identified flows did show a substantial equity investment, but the identified flows comprised less than a third of the total). Conventionally, Gulf investors have seen equity as risky, preferring real estate, which was seen as more secure. The next few years may alter that perception and it is an open question how a global asset downturn will play out. At the very least it should focus attention on current rather than historic risks and increase preferences for more sophisticated risk management tools. We would expect the growing sophistication of Gulf investors, and the liquidity available to them, to be reflected in a wider choice of investment vehicles worldwide, including those in the region itself.

Given the expected continued growth in energy revenues, the investment needs of Gulf individuals will continue to increase. More of this will go into local markets, but for the foreseeable future the Gulf will remain a significant exporter of capital.

In a recent study the Economist Intelligence Unit[10] identified the four expected areas of growing demand related to asset management in the region as:

- Private banking: Leading global banks are moving into the region, setting up one-stop shops for investors. These include more sophisticated products such as derivatives, hedge funds and exchange traded funds. Local banks have tended to ally themselves with global players to offer private banking.
- Private equity: As local markets develop to provide exit routes and liberalisation continues, both local and global players have started to offer private equity products.
- Retail vehicles: The infrastructure for mutual funds exists in GCC countries although there are still barriers, such as the ban on Saudi banks offering third party funds. Growing and more dispersed wealth is creating a demand for collective investment vehicles.
- Real estate vehicles: Property is the traditionally favoured investment in the region and it lends itself to Shariah-compliant products such as real-estate –backed sukuks.

[10] Asset management in the Middle East; the prospects for Global financial Institutions – Economist Intelligence Unit (2007)

4 Comparative Development of GCC Financial Markets

4.1 Introduction

This chapter looks at the current status and structure of Gulf financial centres. The focus on the research is those centres that have been suggested or that have suggested themselves as significant international regional centres. To our knowledge Oman has not done this, although it is developing its domestic market (and indeed is a regional leader in corporate governance standards). Accordingly the focus of this chapter is on Bahrain, Kuwait, Qatar, Saudi Arabia and the United Arab Emirates. The chapter describes the:

- legal and regulatory structure;
- which assets are involved/ traded;
- size and number of listed companies, turnover, brokers;
- focus of activity – banking or securities, domestic/international, purpose (to fund infrastructure, to develop a financial services centre, to raise money for local companies;
- the capital market institutions that exist (regulators, exchanges, infrastructure providers), and who owns and controls them;
- types of investor.

The information in this chapter was derived from a number of sources including publications of exchanges, regulators and central banks; specialist publications, the World Federation of Exchanges and interviews with participants.

4.2 Saudi Arabia – largest regional economy

Saudi Arabia is the largest economy in the region with GDP in 2006 of Saudi Riyal (SAR)1.3trn (£172bn) and a population of 23.6m. It has roughly 25% of the world's oil reserves, which are expected to support current production levels into the foreseeable future. Oil production accounts for approximately 55% of GDP. Fifty percent of the population are under 20 years old and the official unemployment rate is 12%.

4.2.1 Capital market

Shares were first offered to the public in the Kingdom in 1954. The market remained informal until the mid 1980s, when a Ministerial Committee was formed, comprising the Ministers of Finance and Commerce and the Governor of the Saudi Arabian Monetary Agency (SAMA), with overall responsibility for market regulation and development. Saudi Arabia introduced the world's first fully electronic market in the early 1990s, comprising trading, clearing settlement and depositary. A new infrastructure for the market (Tadawul) was implemented in the year 2001.

A Capital Markets Law was enacted in 2003. This defined the future structure in line with international best practice. The law established the Capital Markets Authority (CMA) in 2004 as the agency responsible for issuing regulations, rules

and instructions, and for applying the provisions of the CML. Structurally the CMA has five full-time commissioners appointed by royal decree. It reports to President of the Council of Ministers and is funded by a combination of service fees, fines and government grants.

The CMA is responsible for the:

- regulation of prospectuses;
- licensing of brokers;
- setting of maximum/minimum brokerage commissions (currently 12bp with a minimum per transaction of SAR12);
- regulation of market abuse – insider trading and manipulation are both prohibited under the CML.

The CMA delegates the definition of regulations, implementation and monitoring to the exchange. The CMA regulates fund managers including those owned by banks.

The Saudi Stock Market (Tadawul) in its current form is the only stock exchange licensed to operate in the Kingdom. It is a joint stock company (since 19 March 2007) and all the shares are held by the Public Investment Fund. It is managed by a nine member board nominated by the chairman of the CMA and appointed by the Council of Ministers. The members are:

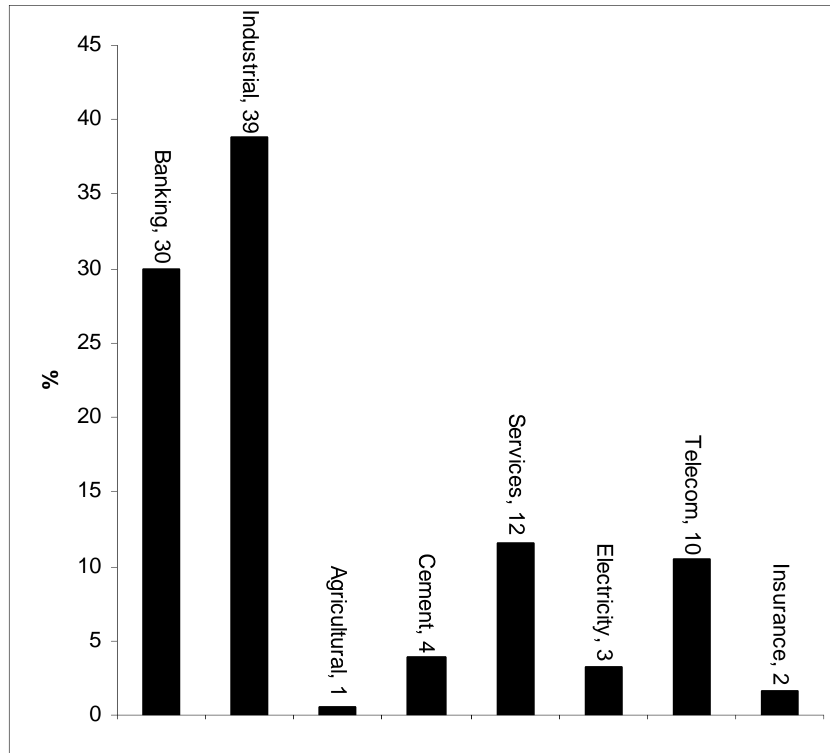
- representatives of the Ministry of Finance, Ministry of Commerce and the SAMA;
- four members representing licensed brokerage companies;
- two members representing the joint stock companies listed on the exchange.

The Tadawul is funded by service fees including those from the clearing and depositary systems which it owns and operates. It has installed sophisticated settlement and trading systems including the OM trading system installed in October 2007

4.2.1.1 Market performance

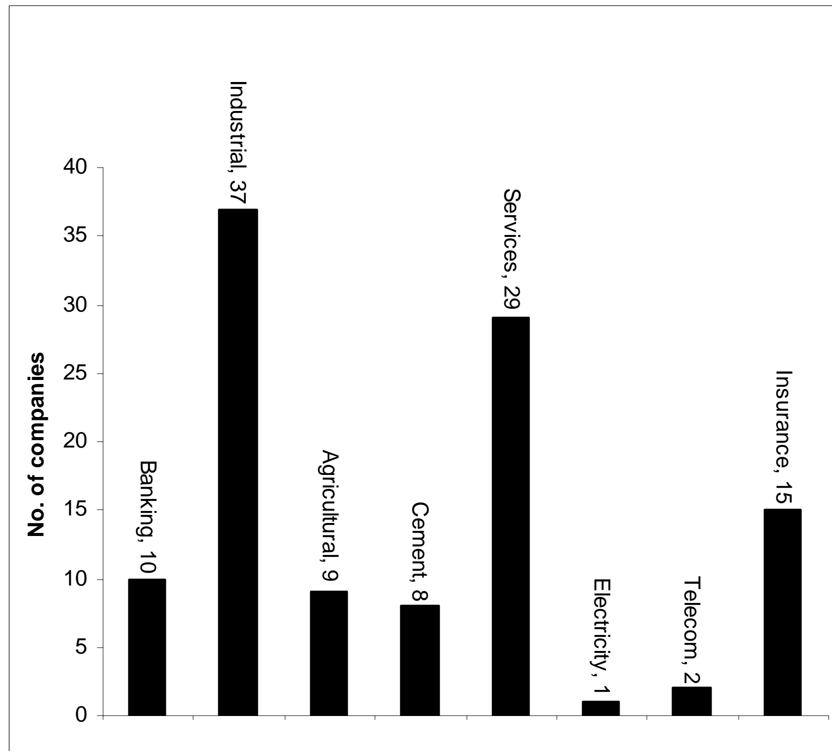
At the end of 2007, the market listed 111 companies with a total market value of SAR1,946bn (£250bn). The sectoral breakdown of companies is shown in Figure 8 and the breakdown by market value is given in Figure 9.

Figure 8: Sectoral breakdown of listed companies by number



Source: Tadawul website

Figure 9: Sectoral breakdown of listed companies by value



Source: Tadawul website

The largest company, Saudi Arabia Basic Industries Corporation (SABIC), represented around 26% of the total market value at the end of 2007. The top ten companies, six of which are banks, represented 69% in total. In 2007, the market attracted 26 IPOs, mainly in the newly liberalized insurance sector; as a result, the market has 15 insurance companies listed[11]. A small number of bonds are listed (four) with a total value of SAR17bn (£2.3bn). Of these, three are structured as sukuks. All offer floating rates based on SIBOR (Singapore interbank rate). There are no exchange-traded derivatives though there is an inter-bank OTC derivatives market.

Firms carrying out securities business must be authorised by the CMA. Firms may be authorised to carry out up to five types of business – principal dealing, fund management, custodian, arranger and advisor. Currently 79 firms are authorised with 51 of them being authorised as dealers. Authorised persons (firms) must have a headquarters operation in the Kingdom of Saudi Arabia, but foreign entities can (and do) gain authorised status. Of the authorised firms, 26 are brokerage firms licensed to trade on the Tadawul. Seven new brokers joined in 2007.

From the mid 1990s until mid 2003 the market index TASI (Tadawul All Share Index) rose steadily, roughly doubling over that period; a compound growth rate of around 8%. Since then, the nature of the market has changed, showing very extreme volatility in recent years as represented in Figure 10. From mid 2003 until spring 2006, the market index rose very steeply from around 2,400 to around 21,000, a compound growth of around 9% per month.

A precipitous fall occurred through 2006, bringing the market index below 7,000 by the end of the year. The high to low range in 2006 was nearly 13,000 points equivalent to 78% of the end 2005 level. From mid 2007 the market recovered somewhat to close at 11,195. In 2007 the market started steadily but fell heavily in the turmoil of late January, losing approximately 20% of its value.

The run up to 2006 was a typical market bubble. The supply of shares had increased as a result of the privatisation of electricity and telecoms (although in both cases the actual issue was a small proportion of the company, with the government retaining the dominant holding). Turnover rose rapidly as investors chased the market up – in 2006 the velocity of turnover[12] (traded value as a percentage of market value) reached 430%, compared with 169% in the previous year. It is worth noting that even169% is fairly high by international standards – in 2006 the UK had a velocity of 125%. These figures are even more remarkable when the low free float of Saudi stocks is considered – in most cases only a small percentage of a company's shares are available to trade, so a velocity calculation using free float would have been even more remarkable.

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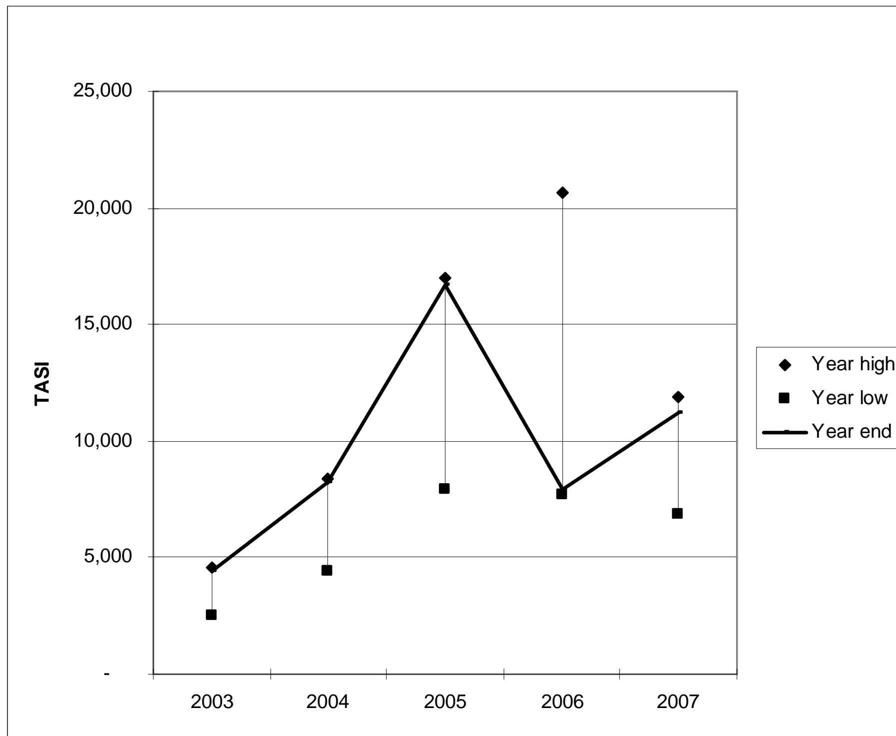
11 The insurance sector has only just begun to develop in Saudi Arabia – in 2005 the World Bank estimated that life insurance premiums represented 0.0055% of GDP and general insurance premiums, 0.45%.

12 Turnover ratios are commonly used as a guide to liquidity. Turnover ratio = turnover/market value as a percentage. Developed equity markets tend to have ratios around 100% or higher, developing markets tend to have 50% to 100%.

Figure 10: Saudi Arabian Market Index – Annual High, Low and Close



Sources: WFE website, Tadawul website

4.2.1.2 Investors

As in other GCC countries, many Saudi companies are controlled by dominant shareholders (including the government) and the free float is a (usually small) minority. Among the top 10 companies by market value, for example, SABIC is 70% owned by the government, Kingdom is 93.5% owned by Prince Alwaleed, and STC (telecoms) and SEC (Electricity) both have dominant government ownership stakes. This naturally raises governance issues, which are reviewed elsewhere in this report.

In 2007, GCC nationals were allowed to invest in the Saudi market on a par with Saudi nationals. Otherwise foreign investors are excluded from direct investment but must use mutual funds. Further, Saudi banks are not permitted to offer third party products (such as mutual funds); it is reported that some are now routing domestic business through their Dubai presences to avoid this restriction.

Institutional investors are not developed in the Saudi market. The mutual fund sector has grown rapidly, however. Regulations restrict the offering management, administration and custodianship of mutual funds to Saudi banks. Mutual finds are not legally separate legal entities from the issuing bank. The regulation of mutual funds is conducted by the Saudi Arabian Monetary Authority (SAMA) as part of its normal banking regulatory functions. According to SAMA there are 215 funds on offer. These offer the normal range of domestic/foreign, aggressive/defensive products. The sums involved remain relatively small, however, with total assets (March 2007) of SAR81bn (£11bn) and 475,000 investors. Of the funds invested, SAR28bn was invested in the domestic

stock market (approximately 2.5% of the total market value). The Saudi market remains predominantly an individual investor market.

4.2.2 Banking

The Saudi banking sector is growing and developing rapidly but remains relatively small. There are currently ten banks licensed to operate in the Kingdom, regulated by the SAMA. Three banks are 100% owned by Saudi nationals and seven are operated as joint ventures with foreign partners. Most of the banks are listed on the stock exchange. The total assets of the commercial banking sector were SAR897 bn in Q1 2007 (£120bn). Total consumer lending amounted to SAR188 bn (£25bn). The top four banks represent around two-thirds of assets.

4.2.3 Overview of Saudi Arabia

Saudi Arabia has huge oil reserves but needs to diversify its economy to provide employment for a growing population. It has made huge efforts to set up the infrastructure for a securities market. Its capital market suffered a significant setback in the rapid rise and subsequent collapse of its stock market in 2006, from which it has not fully recovered. Its stock market is the most dynamic in the region, however, attracting new issuers and brokers at a good rate. Over the longer term, most practitioners say there remain significant barriers to developing financial businesses in the Kingdom, however.

4.3 Bahrain – offshore wealth management centre

Financial services are a major part of the Bahrain economy, representing some 27% of its Bahraini Dinar (BHD)7.5bn (£10bn) GDP. Bahrain was the first Gulf State to find oil and is likely to be among the first to run out (current reserves are estimated to be sufficient for another 20 years). The growth of the financial sector has been a part of a deliberate strategy of diversification.

The financial sector is dominated by the banking sector (representing 25% of GDP). Bahrain acts as an offshore centre for Saudi Arabia (where banking is less well-developed), and other GCC countries. Financial liberalisation in Saudi Arabia and elsewhere in the region is therefore an important factor affecting the continued success of the Bahrain financial services sector. Until recently Bahrain was the only international banking centre in the region but it now faces several competitors – particularly Dubai and Qatar.

Bahrain has no mechanisms for collecting income, corporate, capital gains or wealth taxes. The government budget is funded by oil revenues which cover 75% of the government's expenditure.

4.3.1 Capital market

The Bahrain Stock Exchange (BSE) was set up in 1987 under the BSE law as the only licensed exchange. It is government-owned and its board structure is defined in the law as:

- the Minister of Commerce - Chairman;
- a representative of Ministry of Commerce - Deputy Chairman;

- representatives of the Ministry of Finance and National Economy and the Central Bank of Bahrain (CBB);
- three members elected by the Bahrain Chamber of Commerce and Industry;
- two members representing national banks and auditing firms, to be selected by the Chairman.

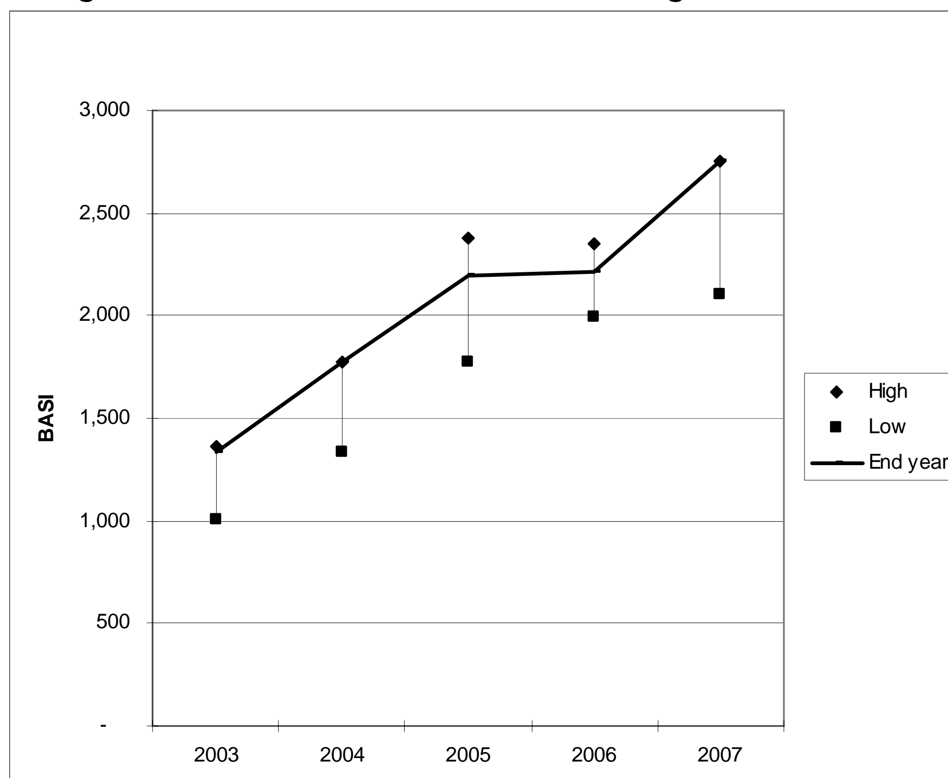
The exchange is regulated by the CBB's Capital Markets Supervision Directorate. The Directorate introduced a new rule book for the exchange in 2006, modelled on international best practice.

4.3.1.1 Market performance

At the end of 2007, the market had 51 listed companies with a market value of BHD10.1bn (£13.5bn). The number of companies has grown only slowly, from 44 in 2003. Bonds can be listed on the BSE; currently 15 are listed. They are a mixture of conventional and sukuk issues. There are 14 broking firms licensed to trade on the BSE.

The BSE managed to escape the worst effects of the turmoil that hit Gulf markets in 2006. The market paused in 2006 but has resumed steady growth since then – Figure 11.

Figure 11: Bahrain market index – annual high, low and close



Source: WFE website, BSE website

Market volatility has been much lower than in other Gulf States, particularly Saudi Arabia.

Trading is very light with a total of 27,000 transactions, having a value of BHD403m (£537m) in 2007. This gives a velocity of less than 4%, which is extremely low by international standards.

4.3.1.2 Investors

Bahrain has no restrictions on foreign ownership. Non-domestic investors make up half of the (very small) value of stock exchange trading.

Bahrain is the leading regional centre for mutual funds in the region. Mutual funds have been subject to regulation since 1992, and there are currently over 2,600 funds registered in Bahrain with total assets under management of about £5bn. Collective investment schemes are regulated and supervised by the Financial Institutions Directorate of the Central Bank. In May 2007, the CBB updated the existing framework to allow for different categories of investors, including hedge funds.

The new framework creates a new category of "exempt" schemes. These schemes are required only to register with the CBB, rather than be authorized, and are not subject to on-going supervision. They are not regulated, but may only be sold to a restricted investor base, namely those able to make a minimum investment of US$100,000 and with at least US$1 million in financial assets. This is also subject to verification by the institution selling the product that the investor fully understands the risks involved.

4.3.2 Banking

As noted, banking activity represents nearly a quarter of all economic activity, and banking assets were BHD180bn at the end of 2006. As would be expected in a financial sector where banking is by far the largest activity, the central bank dominates the regulatory structure, being the regulator for banking, insurance, securities and collective investment schemes.

The CBB was created in September 2006 and took over from the Bahrain Monetary Authority, which had regulated the entire financial sector since 2002 and the banking sector since its creation in 1973.

The CBB licenses all participants in the financial sector. There are over 400 licensed financial institutions (of which 150 are banks), covering a wide range of financial institutions but focused on wholesale banking, insurance and asset management.

Banking has been central to Bahrain's economic development and is likely to continue to be so. With a small domestic banking market, the sector inevitably focuses on offshore banking and is a major regional centre handling funds from Saudi Arabia and other Gulf States where banking regulations are more restrictive. Major international banks have located in Bahrain and others continue to establish their presence there.

Banking sector assets are increasing rapidly and Bahrain has become a leading player in Islamic finance. It currently hosts the largest concentration of Islamic institutions in the region - 24 Islamic banks and 11 Takaful companies.

The CBB has introduced a regulatory framework for monitoring and supervision that reflects the specific needs and concepts of Islamic finance.

4.3.3 Overview of Bahrain

Bahrain has a highly developed banking sector but this is, to a large extent, dependent upon Saudi Arabian (and other GCC) customers who wish to use an offshore centre. International banks are strongly represented in Bahrain. Bahrain's capital market is far less developed, with a small, illiquid stock market. In terms of economic freedom, Bahrain scores comparatively well, having the second highest score in the region. Its zero tax regime is not dissimilar to its neighbours, but its level of business freedom is considerably higher.

4.4 Kuwait – long established stock market centre

Kuwait has a GDP of Kuwaiti Dinar (KWD) 29.6bn (£55bn), of which 55% is derived from oil or gas; its GDP per head ranks fourth in the world. It has roughly 10% of the world's oil reserves, which are expected to support current production levels into the foreseeable future. Oil revenues make up the bulk of government revenues and there are no personal taxes. The total population is some 3m, of which 2m are non-Kuwaiti nationals. The majority of the Kuwaiti-national work-force (86%) is employed in the public sector.

4.4.1 Capital market

Kuwait has the longest history of organised capital markets among the GCC countries. The original Kuwait Stock Exchange was started in the 1970s and its current stock exchange is the second largest in the GCC region. The current capital market structure in Kuwait dates from 1983, when a new law was enacted following the market crash of 1982. The market was closed for two years following the Iraqi invasion in 1990, reopening in September 1992.

The Capital Market Law (CML) of 1983 reorganised the constitution of the Kuwait Stock Exchange (KSE). It placed regulatory responsibilities for the securities industry with the Markets Committee of the KSE. The Markets Committee (MC), which also acts as the board of the KSE, is structured as follows:

- the Minister of Commerce and Industry – President;
- the Director General of the Kuwait Stock Exchange - Vice President;
- a representative from each of the Ministry of Finance, the Central Bank of Kuwait (CBK) and the Ministry of Commerce and Industry (MOCI);
- four members representing the Kuwait Chamber of Commerce, including one broker;
- one public interest member selected by the Council of Ministers, nominated by the Minister of Commerce and Industry.

Other agencies have significant regulatory roles in the securities market:

- licensing of brokers is the responsibility of the MOCI as is the regulation of the primary market;
- regulation of collective investment schemes lies with the CBK.

The IMF, in its 2004 Financial Sector Assessment Program report, commented that "*regulatory powers are fragmented without sufficient formal co-ordination procedures*".

The current CML does not cover insider trading, market manipulation or protection of minorities. The MC has no powers to develop its regulatory capabilities to meet changing needs, without changes in legislation.

The KSE is the only stock exchange permitted under the CML. It is entirely government owned and managed by its Market Committee. The KSE owns and operates the electronic trading system and controls and operates the settlement system, which is mandatory for settlement. Stock is held in paper form, which can lead to settlement delays. The KSE is responsible for supervising brokers, and can warn or cancel licenses, but cannot fine them.

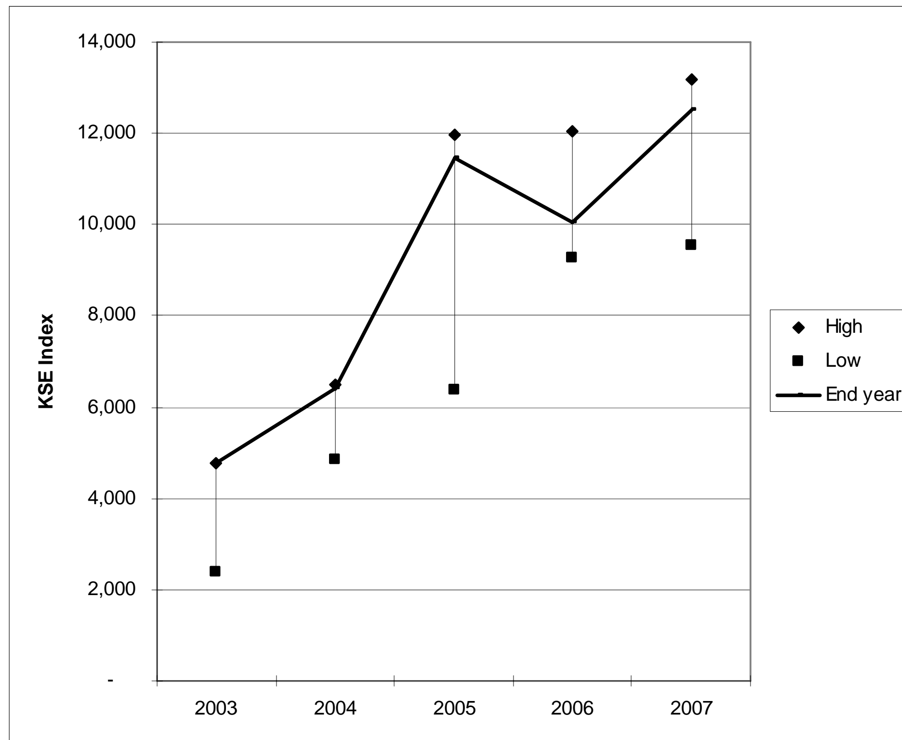
The country is open to foreign direct and portfolio investment but political uncertainty has limited inflows. Kuwait is currently in the process of drafting a new capital market law, which it is hoped will lead to significant inflows; Kuwait has stated that it wishes to attract some $100bn of inflows over the next ten years. Tax on foreign firms operating in Kuwait has recently been substantially reduced from 55% to 15%.

4.4.1.1 Market performance

At the end of 2006, the market value of companies listed on the KSE was KWD30bn (£55bn), making Kuwait the second biggest stock market in the Gulf region (KSE is about one third the market value of Saudi Arabia). There were 142 domestic listed companies and 15 foreign listed companies. The market is relatively liquid by regional standards, with a turnover ratio of 60% in 2006.

The Kuwaiti market has avoided the sharp falls seen in other Gulf markets, although experiencing some volatility in 2006, shown in Figure 12. Because of its recent history Kuwait is to some extent decoupled from the other regional markets and its overall pattern is one of recovery from the political turmoil it has experienced.

Figure 12: Kuwait Market Index



Source: WFE website, KSE website

Kuwait has a well-developed asset management industry comprising some 75 funds managing total assets of KWD21.3 (£40bn) as of May 2007. Most of the funds are managed as discretionary, non-discretionary or custody accounts with conventional mutual funds representing only a small proportion. Shariah compliant investment funds have grown rapidly and now represent 58% of the assets in conventional funds.

4.4.2 Banking sector

Kuwait has seven conventional banks and one Islamic bank. Total assets of domestic banks were KWD36.0 bn at end February 2008 (£68bn).

4.4.3 Overview of Kuwait

Kuwait has a long-established capital market. Recent history has disrupted its progress and it has fallen behind other markets in the region in terms of development. It is making efforts to catch up, for example, by reducing taxes on foreign firms and enacting a new CML. The dominance of the government throughout the economy and financial sector is seen as having the potential to impede progress, however.

4.5 Qatar – international financial centre for the domestic market

Qatar has a GDP of Qatari Rial (QAR) 192bn (£26bn), of which around 62% is derived from oil and gas. The resident population is approximately 900,000, of which some 350,000 are citizens of Qatar. Most Qatari nationals are employed in the public sector. Qatar's reserves of natural gas are among the largest in the world and by 2012 it is likely to be the world's largest producer. At planned

production rates the gas reserves will last into the foreseeable future. Qatar has very substantial plans for infrastructure development, representing some $130bn over the next ten years, both to support gas production and the development of the economy.

4.5.1 Capital Market

Qatar has a two part capital market – a local, domestic market and an internationally oriented financial centre. The two are due to be combined during 2008.

4.5.1.1 Domestic market

The Qatar Financial Markets Authority (QFMA) regulates the local capital market, Including the Doha Securities Market (DSM). The Doha Securities Market (the stock exchange) was established by a decree of 1995 and started trading 1997. The exchange is government owned and its board composition is:

- the Minister of Finance – Chairman;
- three members representing one of Ministry of Economy and Commerce, Central Bank and Chamber of Commerce;
- two members representing brokers;
- two members representing listed companies;
- the General manger of the DSM;
- two expert members (one of whom acts as Deputy Chairman).

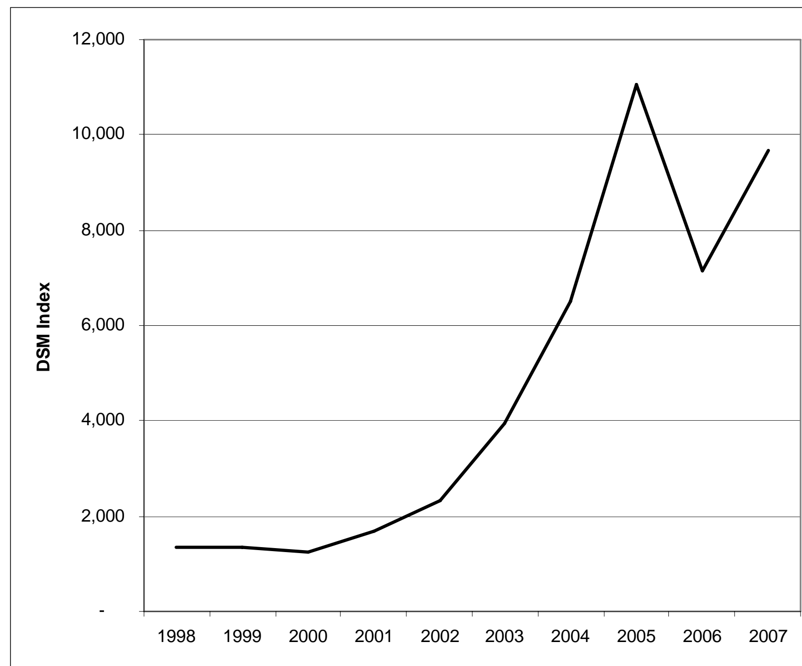
The DSM has self-regulatory powers delegated by the regulator – in practice DSM's Markets Committee is the regulator. The DSM owns and operates both the trading and settlement systems. Unlike most other developing markets the DSM has not gained admittance to the World Federation of Exchanges.

4.5.1.2 Market performance

The DSM lists 36 companies (March 2008). The market value was QAR221bn (£30bn). The listed companies are a mix of small/medium enterprises, some larger privatisations and local banks. Local banks represent some 43% of the market. The largest company, Qatar Industries, represents 14% of the total market value of listed companies. The largest three companies make up 43% of total market value and the top ten represent 77%. Turnover is fairly light with a turnover ratio of 30% in 2006. There are seven firms of local brokers.

The DSM, like other Gulf markets, saw a solid increase in its index up to 2005, followed by a sharp correction in 2006, shown in Figure 13. The correction in Qatar was much less that the correction in Saudi Arabia and the market has since recovered most of the losses.

Figure 13: Doha Securities Market Index



Source: DSM website

4.5.1.3 Qatar Financial Centre (QFC)

The QFC Law, No 7 of 2005, was enacted in March 2005. It establishes the various bodies that are necessary for the operation of the QFC. The QFC comprises two independent entities:

- The Qatar Financial Authority (QFA). This is responsible for commercial strategy and for developing relationships with the global financial community, financial institutions and other key bodies. The QFCA is government-owned with a board chaired by the Minister of Economy and Commerce; it acts as a commercial operator.
- The Qatar Financial Centre Regulatory Authority (QFCRA). This supervises financial services firms and financial institutions that operate in or from the QFC.

The QFCRA is an independent statutory body reporting directly to the Council of Ministers. They appoint its board, which is composed of international market professionals. Its regulations are based on international best practice – largely following the UK model – and it uses English law to resolve disputes. The QFC operates under a separate legal structure:

- The Civil and Commercial Court is modelled on the Commercial Court in London and is the final arbiter in disputes in matters of law.
- The Regulatory Tribunal hears and decides upon appeals relating to decisions of the QFCRA and other QFC agencies.

The scope of the QFCRA covers the full range of financial services activities conducted in or from the QFC. This includes banking, insurance, asset management, financial advisory services, securities and derivatives dealing, and

Islamic finance. It has strong powers of authorisation, supervision and enforcement.

Firms operating in the QFC must be:

- incorporated or registered by the QFC Companies Registration Office;
- licensed by the Qatar Financial Centre Authority;
- in the case of regulated activities (most finance-related activities), authorised by the QFCRA.

QFC registered firms are allowed to operate throughout the country and undertake foreign and domestic currency business. There are currently over 50 firms registered, all of which are significant global or regional financial firms.

The QFC is separate from the State of Qatar and is not limited to a geographic location. QFC licensed entities conducting activities with entities that are resident in Qatar (not QFC members) would be regarded as being outside the State of Qatar.

The QFC is a tax free zone until April 2008; from April 2008 a 10% tax will be levied on profits generated from local business. There are no quotas on the employment of expatriates in the QFC.

The rationale underpinning this development was a need to develop the local capital market so that the large sums needed for infrastructure development could be raised through the domestic market. As a policy, the government wished the market to be onshore – avoiding "suitcase banking". It is widely suggested that firms that do not form part of the QFC will have limited access to business in Qatar[13].

4.5.1.4 Merging the two financial sectors

In July 2007 the government announced its intention to establish a single independent financial regulator. This will bring together the regulatory functions of the central bank, the QFCRA, the DSM and the QFC. The merger is scheduled for mid 2008.

Under the merger, the QFMA (the local regulator), will merge with the QFCRA to form a single regulator, with responsibility for banking, securities and insurance. This new entity, to be known as the Qatar Financial Regulatory Authority (QFRA), will be responsible for licensing participants and the regulation of listed companies. The DSM will be the front-line regulator regarding market abuse.

The transition is expected to last three to five years; during this time, local companies listed on the DSM will be expected to raise their standards to international levels. A new corporate governance law is planned to support this process.

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[13] Clifford Chance, "Doing Business in the Qatar Financial Centre" (2007)

The DSM will be incorporated as a company in 2008 with all of its shares being owned by the government. An IPO of the exchange is being considered but there is no timescale.

4.5.2 Banking sector

The Qatari banking sector is relatively small with total assets of QAR250bn (£35bn). Foreign banks are permitted to operate on a par with local and regional banks. Domestic banks represent over 90% of total bank assets and seven of these are listed on the DSM.

4.5.3 Overview of Qatar

Qatar is developing a financial centre to support its own capital market needs. It has augmented its relatively basic local market with a financial centre based around international regulatory standards, attracting international participants. A merger of the two structures is underway to create a single structure which, it is hoped, will apply international standards to the entire Qatari financial sector

4.6 United Arab Emirates – fragmented local markets and an international centre

The UAE consists of six emirates; it has a federal structure, but the individual emirates are largely self-governing. The UAE has a total GDP of some UAE Dirham (AED) 620bn (£84bn). The largest emirate, Abu Dhabi relies largely on oil revenues derived from its extensive reserves and has a GDP of about AED365bn (£50bn). Dubai, the second richest, has a GDP of AED175bn (£24bn) but has a much lower reliance on oil as its reserves are nearing exhaustion. Dubai relies more heavily on tourism and air transport, and it has opened a number of free zones such as those for IT and media.

4.6.1 Capital market

The UAE has a federal central bank and securities regulator, the Emirates Securities and Commodities Authority (ESCA). Individual emirates have their own local securities markets – currently Abu Dhabi and Dubai have these. The Abu Dhabi Securities Market (ADSM) is also permitted to establish centres and branches in other Emirates and has done so in Fujeirah, Ras al Khaimah, Sharjah and Zayed City. Furthermore, individual emirates can create international financial centres as Dubai has done and as Ras al Khaimah is tentatively planning to do.

National restrictions limit foreign ownership to zero in some companies and impose a maximum percentage in others.

4.6.1.1 Emirates Securities and Commodities Authority (ESCA)

ESCA was established on February 1st 2000 to oversee Emirates securities and commodities markets. It acts as the listing and licensing authority and reports to the Ministry of Economy and Commerce. Its board is constituted thus:

- two members representing the Ministry of Economy and Commerce;
- two members representing the Ministry of Finance and Industry;
- one member representing the central bank;

- four specialised experts nominated by the Minister of Economy and Commerce.

4.6.1.2 Abu Dhabi Securities Market (ADSM)

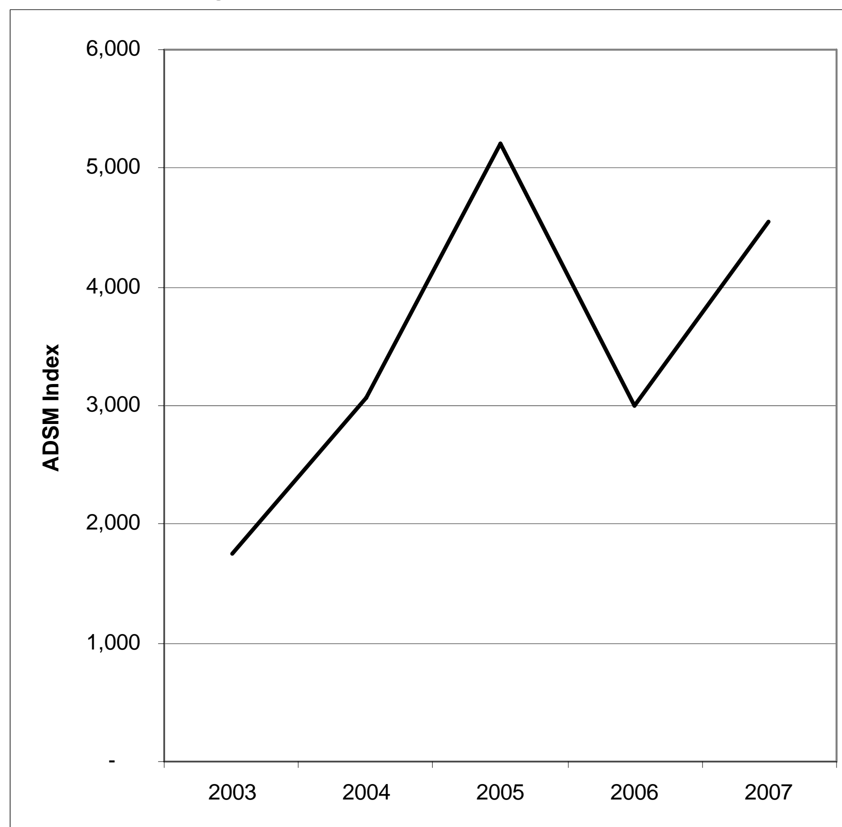
The ADSM opened on November 15th 2000 and is regulated by ESCA. It is a Government owned corporation, with a board composed of seven members, nominated by the government under the Amiri Decree No. 8 of 2000. The members of the board hold office for a term of three years. The settlement infrastructure is owned by and operated by the ADSM.

4.6.1.3 ADSM Market performance

The ADSM lists 64 companies with a market value of AED444.9bn at end of 2007 (£60bn). Trading volumes are reasonable at AED 175bn (£24bn, 2007) giving a turnover ratio of 39%. Turnover increased sharply in the final quarter of 2007 which, if sustained, would indicate a significant improvement in liquidity. There are 98 brokers licensed by ESCA, who may also trade on other Emirates stock exchanges regulated by ESCA. ADSM has recently appointed a new CEO from a European stock exchange.

Figure 14 shows the index performance, which is similar to the other smaller gulf markets, with a downturn in 2006 followed by a reasonable recovery in 2007.

Figure 14: Abu Dhabi Market Index



Source: WFE website, ADSM website

4.6.1.4 Dubai Financial Market (DFM)

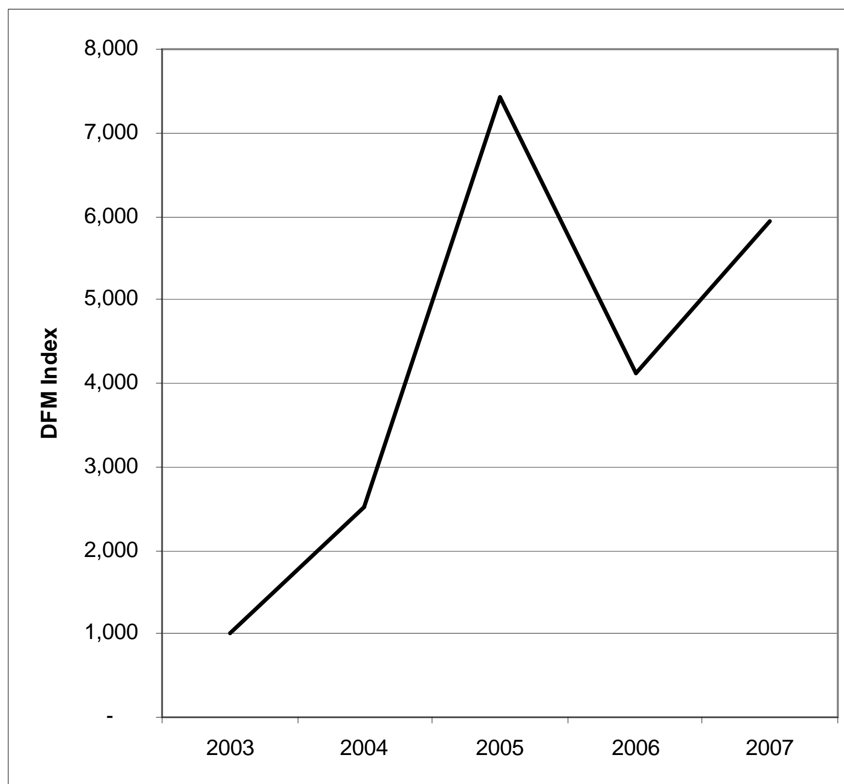
The DFM opened 26 March 2000 and is regulated by ESCA. It is a government owned corporation. The settlement infrastructure is owned by and operated by the DFM. Unlike most other developing markets, the DFM has not gained admittance to the World Federation of Exchanges.

4.6.1.5 DFM Market performance

The exchange lists 55 equities, six bonds and 15 mutual funds. The market value was AED480bn as of March 2008 (£65bn). Emaar Property, the largest company, represents 24% of the total market value; the top five companies represent 56%, and the top ten make up 75%. Turnover in 2006 was AED347 (£47bn) on a market value of AED320 (£43.5bn) at the end of 2006. This gives a turnover ratio of over 100% - on a par with many developed exchanges and higher than any Gulf market except Saudi Arabia. The DFM has 96 brokers, who may also trade on other Emirates stock exchanges regulated by ESCA.

The market index, shown in Figure 13, displays a similar pattern to other Gulf markets, with a strong rise to 2005, a sharp reversal in 2006, and a partial recovery in 2007.

Figure 15: Dubai Financial Market Index



Source: DFM website

4.6.1.6 Dubai International Financial Centre (DIFC)

The DIFC opened in September 2004, with the explicit task of setting up a financial centre which will attract foreign businesses to raise capital and be traded in Dubai. The DIFC is based on a 110-acre plot granted by the government to the DIFC. The DIFC is permitted to operate an economic free zone based on this plot, and acts a commercial development agency. The free

zone has its own laws, regulations and legal jurisdiction. Regulation of activities in the free zone is the responsibility of the Dubai Financial Services Authority (DFSA).

The DFSA is an independent entity with its own board, composed of international market practitioners. It has developed a regulatory structure based on best-international practice – in effect its banking and securities regulations follow the UK model and its insurance regulation is a more eclectic structure based mainly on Bermudan practices. The DFSA uses English law to resolve disputes. In effect, the free zone is ring-fenced from the rest of the economy.

In contrast to the Qatar model, the DIFC has sought to set up a securities exchange within the free zone – the DIFX. The DIFX is intended to attract listings from international companies wishing to raise capital or be traded in Dubai. At present, however, the number of listings has remained small and trading is believed to be slow (no figures are published)[14]. There are 42 current listings – 12 sukuk, six conventional debentures, 12 structured products and 12 ordinary shares (including ADRs/GDRs).

Firms operating in the DIFC are eligible for benefits such as a zero tax rate on profits, 100 per cent foreign ownership, no restrictions on foreign exchange or repatriation of capital, operational support and business continuity facilities. The DIFC has some 400 registered firms, although this total includes many non-financial ancillary companies that operate in the DIFC building. Licensed DIFC companies are not permitted to engage in domestic currency transactions and, in practice, must confine their activities in Dubai to the DIFC zone and other licensed firms.

As well as the DIFX, the DIFC hosts a futures market trading an oil contract. The exchange is operated by the Dubai Mercantile Exchange (DME) - a joint venture between Tatweer, a member of Dubai Holding, the New York Mercantile Exchange, Inc. (NYMEX) and the Oman Investment Fund (OIF). The Exchange has developed and lists the Oman Crude Oil Futures Contract[15].

Recently another of the emirates in the UAE, Ras Al Khaimah, announced that it too planned to set up and develop a financial city. Arguably there is an element of speculative development here. Our conversations suggested that opening a financial centre has proved to be a quick way of raising the value of real estate; other states, seeing the rapid rise of property values in Dubai, for example, may be interested in benefiting from property boom. The developers and promoters of Ras Al Khaimah talk of "a landmark on the coastline of the Gulf", "novel design", and "an icon" but have not clearly addressed the needs of, and demand for, another financial centre.

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[14] IFLR, "Built on Shifting Sands", July 2007

[15] Oxford Institute for Energy Studies, "Middle East Crude Pricing and the Oman Crude Oil Futures Contract: A Critical Assessment" (2006)

4.6.2 Banking Sector

The UAE has a relatively large banking sector. The Central bank of the UAE licenses 22 local banks and 25 foreign banks to operate in the UAE. Total assets of licensed banks amount to AED 1,024bn (£145bn Sept 2007).

4.6.3 Overview of UAE

The UAE has the most complex financial sector structure in the region. This is partly a consequence of the federal structure and partly the effect of different endowments of oil reserves – Abu Dhabi has immense reserves while the other emirates, particularly Dubai, have considerably less or are coming to the end of their resources. The regulator is widely considered to be a relatively sophisticated organisation, but its writ only extends to the local markets – not the DIFC. Both Abu Dhabi and Dubai have relatively active local stock markets. In addition, Dubai has the DIFC which is a free zone outside the remit of ESCA and which offers an international standard regulatory structure covering firms and transactions within the geographic area of the DIFC. DIFC has attracted many global financial companies and has more of an exchange-like structure than the Qatar centre; attracting listings has been more difficult however.

4.7 Key metrics – Gulf capital markets

Table 5 summarises the key capital market metrics for the GCC countries. It shows the size of the banking sector and the stock exchange sectors. As well as the GCC countries, the table also shows data for the UK and a number of other significant, developing economies that have similarities to, links to, or are seen as competitors to, the Gulf markets.

Table 5: Selected Capital Market Metrics 2006

			Stock Exchange		
	GDP	Bank assets	Market value	Turnover	Companies
	£bn	£bn	£bn	£bn	
Saudi Arabia	172	118	167	702.0	111
Kuwait	55	68	55	30.0	157
Bahrain	10	90	11	0.7	51
Qatar	26	21	30	10.0	36
Abu Dhabi			40	10.0	
Dubai			65	47.0	
UAE	84	145	-	-	
Oman	18	9	8	0.1	
Total GCC	**365**	**451**	**376**	**799.8**	**355**
UK	1,303	1,887	1,938	2,188.2	3,256
Malaysia	72	60	120	38.3	1,025
Indonesia	204	87	71	25.0	344
Egypt	217	69	48	24.5	595
India (NSE)	544	344	395	216.6	1,156

Source: WB, BIS, WFE, stock exchanges, central banks

The comparisons in the table bring out a number of points:

- While still small, the stock markets of the GCC countries are of similar orders of magnitude to other significant developing economies, even though they have grown rapidly from fairly recent beginnings in most cases. In terms of turnover, the markets in the UAE and Qatar show comparable levels of liquidity. In relation to a highly developed economy, however, such as the UK, the stock markets of the Gulf are very small.
- Saudi Arabia is the capital market giant of the region, with its stock exchange market value representing 44% of the GCC total. Its turnover in 2006 completely dwarfed the turnover in the other Gulf markets. It is worth noting that 2006 was an extremely turbulent year in the Gulf markets, particularly for Saudi Arabia, and turnover levels are currently lower - but still far larger than for any of the other markets.
- The number of companies listed is small in comparison to other markets. IPO numbers are not large, so to develop the markets a significant increase in new listings is required. These could come from more listings of smaller firms – currently family owned. Further privatisation is also likely to be required, however, to increase the range of large companies available. This should be combined with measures to increase the free float of current listed companies. The markets tend to be dominated by a few large companies, or a single company in the case of Saudi Arabia and Dubai Financial Market. These companies are typically large State-owned conglomerates, banks or property companies.
- The banking sectors in the GCC countries appear generally well-developed, bearing a similar relationship to GDP as in the other comparator countries. Bahrain, as an offshore banking centre, is exceptional in having a disproportionately large baking sector- although in terms of total assets it is smaller than UAE and Saudi Arabia.

A number of other points can be drawn from the descriptive material in the chapter:

- The capital markets of the region (excluding the international financial centres in Dubai and Qatar) are dominated by the government. In general, the government owns the stock exchange, appoints the board and is also a significant shareholder in many of the listed companies.
- With the exception of Kuwait, the Gulf States have set up independent regulatory bodies for the capital market. There are, however, major questions about the independence of the regulators since boards are usually dominated by government nominees from the responsible departments. The sense is one of sharing the board places among the government stakeholders, rather than selecting on ability.
- Institutional investors in the conventional sense are not yet developed. There are mutual funds in many of the countries but investment is mainly driven by retail - and retail in the Gulf tends to mean a small number of high net worth individuals, often with strong links to the ruler/government. Foreign investors are limited or excluded in most of the larger markets.
- Markets are dominated by local brokers. Some markets allow foreign firms to operate but their presence is small.

- The Gulf markets are strongly synchronised; all have shown very similar patterns of price movement in recent years. Saudi Arabia saw the most extreme movements, others experienced more moderate declines in 2006, with partial recovery in 2007.
- The two international financial centres, Dubai and Qatar, have similarities but different explicit objectives. Similarities include their importing of foreign regulatory and legal structures along with taxation and regulatory regimes designed to attract global players. In terms of their objectives, however, Dubai wishes the DIFC to become an international centre – essentially an offshore centre like Singapore, with a key objective here being revenue. Qatar, in contrast, aims to develop a financial market to allocate capital resources more efficiently. The QFC is much less strongly separated from the rest of the economy and this facilitates the planned consolidation of the market – something which would be much more difficult in Dubai.

4.8 Outlook for Gulf financial centres

Having described the Gulf financial centres, this chapter attempts to assess their likely future development. Given the large number of financial centres, there is a question as to which of them and to what extent will develop into significant international financial centres, develop into significant national capital markets supported by a regional hub, or stabilise as relatively small, individual developing markets.

Market integration in other regions has been aided by a common currency. There is a plan to implement a common Gulf currency by 2010, but there is widespread scepticism about this schedule, not least because of the high and differential rates of inflation currently being experienced in the Gulf States. Expectations are that the common currency is unlikely to happen before 2015. Currently the currencies are tied to the $US (except for Kuwait, which has left the dollar peg). In principal, then, a common currency would not have too much impact on the integration of the regional markets. Even if a common currency were implemented on schedule there remain many other barriers to regional integration of markets, however, including the highly independent outlook of the GCC states combined with the structural and cultural differences mentioned in Chapter 3.

All of the Gulf States have developed domestic banking, local capital markets and fund management sectors. In this they are similar to other markets that have developed in recent years, although the degree of direct government involvement in the stock exchange and regulator is relatively high and, over time, may be a barrier to development. The Gulf States are all relatively small economies, especially if the oil revenues are excluded, and so the likelihood is that their own domestic banking and capital market sectors will be similarly small in comparison to the major global centres.

The Gulf States are not like other developing markets, however. Some distinctive attributes include that the Gulf States are:

- reservoirs of vast private and public wealth which requires investment in capital markets;

- motivated to develop significant financial centres, either to aid resource allocation, to provide alternative income streams, or to provide employment for a growing population;
- a significant Islamic bloc with a growing interest in Shariah-compliant financial markets.

These features give the States significant strengths in competing for contestable parts of international capital market business. Possible roles include:

- regional banking centres;
- international fund management centres to manage the regional flows of investable capital market funds;
- regional global capital markets, supporting other regional markets and attracting global players;
- global capital market centres, attracting business from outside the region.

4.8.1 Saudi Arabia

Saudi Arabia is by far the largest economy in the region and has the largest oil reserves of any of the Gulf States. It also has the largest population and chronic under-employment. Unlike some other States which have used their oil/gas wealth to fund quasi-government employment, the Saudi population is too large for this to be a long-term option.

It has the largest capital market in the region and a dynamic stock market which is more diversified than others in the region offering a wider rage of industries. It has made significant progress in developing a regulatory structure covering banking, securities and insurance. The market is still overshadowed by the traumatic volatility of recent years, however, which may impede further development.

It is also worth noting that the market remains relatively closed and restricted compared to other Gulf markets, and certainly compared to global markets. This restricts its access to human capital from outside the region and is a barrier to development of the market and of the regulatory bodies. Currently a large part of its citizens' private banking and investment activity is carried out in offshore centres, in particular Bahrain.

It seems likely that Saudi Arabia will become a significant domestic capital market and, with relaxation, will attract international investment. It seems less likely to attract capital market business from outside the country, however.

4.8.2 Dubai

Dubai is a relatively small economy, with declining oil revenues and limited reserves. It has successfully developed other diversified activities, such as tourism, and has been a leader in developing regional centres of excellence in areas such as media and IT, based on specific locations.

Its domestic capital market is small, reflecting the size of the economy, and subject to local regulatory standards which are not always regarded as high externally. The local market may have aspirations to become more significant internationally but it faces an uphill struggle - not least because to become a

global centre requires attracting global players and the DIFC has firmly occupied that ground.

The DIFC was an innovative development and offers an attractive location to global players, in terms of regulation, taxation and freedom to move staff and capital into and out of the country. The DIFC's decision to create an exchange from scratch has proved difficult to fulfil, however, while its geographically restricted structure prevents it from integrating with the rest of the capital market in Dubai and the UAE.

Unless the local markets are somehow integrated into the DIFC structure, so that their regulation is brought closer to international standards (which would be difficult), it is hard to see them attracting a high degree of foreign interest. The future of the DIFC depends upon its ability to develop business on the back of its undoubted attraction as a location for global financial firms.

4.8.3 Abu Dhabi

The UAE has large oil reserves and a reasonably sized local capital market. In recent years it has presented itself as a cultural rather than a business centre. Very recently it has presented its stock exchange as a possible regional leader, but there is little evidence so far that this will happen.

4.8.4 Bahrain

Bahrain has little oil (although it has a large refining industry for Saudi oil), and has a long tradition as an offshore banking centre for citizens of other Gulf States. It therefore has strong infrastructure including human capital and standard-setting institutes. Its capital market is very small, however, and while its banking sector is large it has been caught up by the development of banking in the other Gulf States.

Bahrain is a relatively open and liberal economy, although it is worth noting that the latest survey data reported here does not record a large difference between it and the other Gulf States. Its fiscal advantages have also been eroded by moves in other states. Similarly, the previous advantages from having all the major banking players present in the country have been eroded by the opening of offices by international banks in the Dubai and Qatar financial centres, and advantages in wealth management are similarly threatened. In the longer term, international firms may consider whether their private banking operations are best maintained in Bahrain, if Bahrain does not offer the scope for the full range of business that is available in other centres.

Bahrain's historic banking strength has therefore benefited from the lack of development and restrictive environments elsewhere in the region. This advantage is being eroded, which makes Bahrain vulnerable. As a small country with a small population it is likely to be able to prosper at its current scale of operations, but on current trends may be unlikely to retain its position as the regional centre.

4.8.5 Qatar

Qatar has large gas reserves and a small population. It has large infrastructure needs, however, which it plans to finance through its own capital market. Its

domestic capital market is small, reflecting the size of the economy, and is subject to local regulatory standards which are not externally always regarded as high.

Following Dubai, Qatar's development of a financial centre was bold and displays innovative features. It offers an attractive location to global players, in terms of regulation, taxation and freedom to move staff and capital into and out of the country, which has attracted many key players. In addition, the infrastructure plans mean that there is large local capital market business to be transacted – and it is certainly implied that Qatar expects participants in those infrastructure financing plans to be on the ground in Doha rather than "suitcase bankers".

Qatar has opted not to create a separate international exchange, intending instead to graft the domestic and international structures together and so raise the regulatory status of the whole country. Plans are well-developed to merge the two structures this year and, if carried out successfully, will present an integrated market with high regulatory standards.

4.8.6 Kuwait

Kuwait has the longest established stock market in the region. Its turbulent recent history has slowed development, however, and its capital market structures appear less well-developed than those of its neighbours, so in this sense it has fallen behind.

Kuwait has very considerable oil revenues, and major investments with a small population, meaning that the country is under little pressure to diversify its economy – although it may, of course, choose to. Its population is largely employed in the government sector, with little indication that this is likely to change.

Kuwait is belatedly making moves to develop its capital market infrastructure and will no doubt emerge as a significant local market attractive to foreign and domestic investors; the opportunity to become a global or regional centre may have passed, however.

4.8.7 Summary of strengths and weaknesses

Table 5 summarises the strengths and weaknesses discussed in this chapter.

Table 5: Summary strengths and weaknesses of Gulf centres

	Strengths	Weaknesses
Saudi Arabia	- Large economy - Large population needing work - Large capital market	- Large oil reserves reduce motivation - Closed to foreign financial staff - Restrictive financial regulations
Dubai	- Motivation, given limited oil reserves - Experience with free zones - Open to foreign firms and employees - More developed local markets	- Free-zone structure restricts integration with rest of economy regulatory structure - Exchange-based model very dependent upon foreign listings
Abu Dhabi	- Relatively open, like Dubai	- Large oil reserves reduce motivation - Little international presence - Less of an established base to build on
Bahrain	- Motivation, given limited oil reserves - Long experience - Banking strength - Human capital - Economically liberal – though differences are slight compared to much of GCC	- Weak domestic capital market - Vulnerable to loss of competitive advantage through liberalisation and development elsewhere in GCC
Qatar	- Needs capital market to finance infrastructure development – so more domestic business for foreign firms that in Dubai. - Open to foreigners - Relatively easy to integrate international financial centre and domestic market.	- Large oil and gas reserves reduce motivation
Kuwait	- Long established - Substantial local market	- Large oil reserves reduce motivation - Held back by turbulent history

It would be bold to predict the outcome of developments in the Gulf States. It does seem likely, however, that the number of international financial centres that a region can support is likely to be relatively small. East Asia supports two, Europe one, and North America one, for example. In addition, Shanghai and Mumbai are emerging as strong regional centres driven by the sheer size of their domestic economies and may, in time, eclipse the off-shore Asian centres.

The wealth and economic importance of the Gulf region could clearly support a significant financial centre (or centres) acting as a regional hub. Such a centre could conceivably attract business from outside the region, but competition from Mumbai and other Asian centres on one side and London on the other – not to mention other significant centres in the region such as Cairo – would be intense.

Among the possible candidates for such a role in the GCC region, it is hard to see any of the local markets developing the necessary critical mass and regulatory authority necessary. There are major differences between the explicitly international financial centres in Dubai and Qatar. In particular we have noted that the Qatar structure allows easier integration with the domestic market – a domestic market which will make large capital demands in the future. It should be noted, however, that developing a financial centre requires determination and a willingness to make tough decisions, and the ability to be responsive in order to retain global players. In the long term, then, it may be that the motivation of declining oil revenues and the experience of attracting international players in other fields will be decisive – both of which are true for Dubai.

5 Islamic Finance – Growth and Prospects

Islamic finance is growing rapidly in the wholesale area. This chapter outlines some of the issues surrounding Islamic finance. It does not attempt to summarise the principles or products of Shariah-compliant products[16], or the detailed regulatory issues surrounding them[17] or the emerging infrastructure of the markets themselves[18].

It is useful to note that although Islamic finance is a popular source of funds and attracts much attention, it is far from becoming the dominant source of funding in Islamic markets. For example:

- Although Indonesia is the most populous Muslim country, only 1% of its domestic bond issues were Islamic and it lists only $5m worth of Shariah-compliant funds. A key reason for this limited impact is Indonesia's legal and taxation system, which imposes capital gains tax when changing to a Shariah-compliant structure.
- About one fifth of Pakistan's issuance to June 2007 was sukuk, up from zero in the same period last year.

In addition, while the Arab region would be a natural centre for Islamic products, the main development to date has been elsewhere, especially in Malaysia:

- Malaysia has issued $4.7bn worth of Islamic bonds during the first three quarters of 2007, some three-quarters of its total issuance.
- In 2005, over 85% of global sukuk issues originated in Malaysia.

Initially, sukuk tended to command a premium (that is, offer a lower yield), as one would expect on assets that are targeted at specific investor needs. Now, however, the premium has been squeezed out as investor interest has increased (and so the issues are attractive to non-Islamic investors). We would expect the premium to re-establish over time, reflecting the limitations and higher costs. We gained the sense that the market is currently issuer-driven (that is, issuers want to be seen to be Shariah-compliant), since the investor demand for conventional bonds would more than meet the need of current issuers.

5.1 The GCC Debt Market

Economic growth in the region has led to a rapid expansion of business activities. The GDP of the six GCC states is estimated at $675 billion with an average GDP growth of 6.6% for the six nations (UAE and Qatar achieving a growth rate of 8.5% and 8.4 respectively[19]). The GCC's SWFs accumulated from oil revenues bred new form of indigenous Sovereign Investment Corporations (SICs). This has

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[16] These are well summarised in "Critical Issues in Islamic Banking and Financial Markets", Saiful Rosly, Dinamas Publishing, Malaysia, 2005

[17] See, for example, Archer, S and Rifaat Ahmed Abdel Karim *Islamic Finance: the Regulatory Challenges*, John Wiley, 2007

[18] Islamic Capital Market: Fact Finding Report, IOSCO, 2004

[19] *GCC Annual Banking Review*, November 2007.

been stimulated by economic reforms devised to entice inward and outward Foreign Direct Investment (FDI) in and out of the region[20]. As momentum grew, the Gulf SWFs and their investment corporations embarked on international purchases of stakes in major global enterprises, partly funded by debt.

In addition to the need for capital to finance outward investment, there is considerable demand by sovereign and corporate enterprises for capital to finance development projects in the region. Governments continue to announce new projects in the oil, gas and petrochemical sectors, as well as real estate and infrastructure development. Equally, the increasing role of the private sector in the GCC infrastructure created significant demand for Shariah-complaint financing. Traditionally, the dominant family-owned private sector advocates Shariah-compliant investment. History tells us that almost all the Islamic banks were set up to meet demand from private companies who preferred their business to be financed in compliance with Shariah law.

Islamic retail banking has also expanded to facilitate the growing demand for Islamic financial services. The figures of return on equity (ROE) for retail banking in 2006 varied from 2.75% to 6.94% by the Al Rajhi Bank of Saudi Arabia. In terms of Shariah-compliance, the biggest growth area is that of Islamic mortgage lending. Demographic change in the region and land law reforms have created demand from home buyers, in particular from expatriates who were denied this right of ownership in the past. The value of mortgages in the UAE nearly doubled to $12.5 billion in the year to June 2007[21], for example. No accurate figures are available to determine the true current demand for mortgage finance, but mortgage housing finance is currently estimated to be only two per cent of the GDP[22], indicating potential for a significant increase in demand.

This general increase in demand for capital has led to a growth in demand for Shariah-compliant financial instruments, which, in turn, has led to a range of innovation. This includes diversification, consolidation, product innovation, international integration (global sukuk issues) and most recently securitisation[23]. The market is set to continue to develop in 2008 and is expected to be in excess of $1 trillion by 2010[24].

International financial institutions have been eager to tap into this market and help further its development by providing mechanisms for its growth; for example, European and US investment banks were pivotal in the issue and underwritings of significant Gulf debt securities. Bonds issues and Islamic sukuk

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20 Sovereign Investment Corporations (SIC's): This phenomenon surfaced as a result of the accumulated Sovereign Wealth Funds generated by oil revenues. Examples include: Saudi Arabia General Investment Authority (SAGIA). Abu Dhabi Investment Authority, (ADIA), Qatar Investment Authority (QIA), Kuwait Investment Office (KIO), Dubai International Capital (DIC).

21 *Gulf Annual Banking Review*, November, 2007. page 31.

22 *Gulf Annual Banking Review*, November, 2007. page 31

23 *Emerging Islamic Capital Markets: a quickening pace and new potential*, Zamir Iqbal and Hiroshi Tsubota, The World Bank, 2005.

24 *Gulf News Quarterly Financial Review* 3, August 2007, Interview with Edwin Ball, COO, Gulf Finance House.

issues have both increased sharply, and the region has opened a number of new financial markets, for example:

- the Dubai International Financial Centre (DIFC);
- the Bahrain Financial Harbour (BFH);
- the Qatar Financial Centre (QFC).

Reuters report that the region's debt capital market (DCM) has the potential to be worth up to $250 billion in two to three years, from approximately $2.5 billion currently[25]. More borrowers are considering offering sukuk sales in Europe and the United States to gain better pricing for longer-term maturities[26].

5.1.1 Factors Underpinning the Growth of the Islamic DCM

The broad political and economic change in the region has undoubtedly been the principal force behind the rise of the Islamic capital market. The industry now encompasses a wide range of areas, including corporate and project finance, Islamic investment funds, Islamic Real Estate Investment Trusts (IREITs), Shariah-compliant asset-backed securities and Waqf Asset Trusts (WAT's) to name a few. This chapter outlines some of these factors.

5.1.2 The Size of Shariah-Compliant Debt-based Instruments in the GCC

Islamic debt-based instruments now make up a considerable percentage of the region's debt market. In the UAE, Qatar, Bahrain and Saudi Arabia, semi-government investment corporations, which largely invest in real estate (such as Nakheel and Emaar in UAE), have used the sukuk to raise funds. DIFX now lists a five-year US$1.25billion sukuk issue, which attracted more than US$2bn in subscriptions, and for which more than two thirds of the subscriptions came from outside the Middle East region[27]. Table 6 shows the recent Shariah-compliant corporate issues in the GCC, which in 2007 totalled US$ 16.2 billion. This represents 19% of the worldwide total US$87.4 billion issues. The trend is expected to continue over the next few years.

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25 Reuters report, 2007.

26 Interview with Arul Kandasamy, Head of Islamic Markets, Barclays Capital, *Emirates Today*, November 6 2007.

27 Islamic Bond Report, 2007, *ISI Emerging Markets*, a Euromoney Institutional Investor Company.

Table 6: GCC Islamic Corporate Issues: 2007

Issuer	Country	Lead Manager/ Bookrunner	Type of Issue	Amount in US$ million
Tamweel PJSC	UAE	Barclays Capital	Exchangeable Sukuk	300
Jebel Ali Free Zone FZE (JAFZ)	UAE	Barclays Capital Deutsche Bank Dubai Islamic Bank Lehman Brothers	Sukuk Al Musharakah	2,042
Dubai International Financial Centre (DIFC))	UAE	NA		1,000
The Nakheel Group	UAE	JP Morgan	Exchangeable Sukuk	750
RAK Properties	UAE	NA	Sukuk	1,500
Dana Gas	UAE	JP Morgan	Mudharabah	1,000
Omniyat Holdings	UAE	NA	Sukuk	150
Ras Al Khaimah Investment Authority	UAE	Credit Suisse HSBC Amanah National Bank of Dubai	Sukuk Al Wakala	325
Thani Investment Group	UAE	Emirates Islamic Bank Liquidity Management Centre	Sukuk Al Musharakah	100
Total UAE Issues				**7,167**
Saudi Basic Industries Corporation (SABIC)	Saudi Arabia	NA		1,336
Saudi Electricity Company (SEC)	Saudi Arabia	-		1,336
Zamil Group Holding Company	Saudi Arabia	-	Sukuk Al Ijara	1,000
Dar Al-Arkan Real Estate	Saudi Arabia	-		1,000
Total Saudi Arabia Issues		**-**		**4,672**
Kuwait Resorts Company (K.S.C.C.)	Kuwait	Kuwait Financial Centre	Sukuk Al Ijara	50
Abyaar Real Estate Development	Kuwait	Merrill Lynch	Murabahah	700
Total Kuwait Issues				**750**

Doha Bank	Qatar	Doha Islamic	Sukuk	1,000
Qatar Real Estate Investment Company (Alaqaria)	Qatar	NA	Sukuk	270
Qatar Real Estate Investment Company (Alaqaria)	Qatar	-	Sukuk	300
Barwa Real Estate	Qatar	-	Sukuk	800
Total Qatar Issues		**-**		**2,370**
Bahrain Islamic Bank	Bahrain	-	Sukuk	1,000
Gulf Holding Company	Bahrain	-	Sukuk	NA
Bahrain Financial Harbor	Bahrain	Liquidity Management Centre	Sukuk Al Ijara	250
Total Bahrain Issues				**1,250***
Total GCC Issues				**16,209**

* excluding the Gulf Holding Company.
Source: Various, IFIS's Sukuk Report, 2007.

5.2 New Islamic Products

The sukuk 'bond' (discussed above) is the best-known and most widely-used Islamic financial product. Equity is also common as, under Shariah law, equity investment is generally permitted on the same terms as in the West (with, of course, the exception of investment in firms which engage in prohibited activities). There have been significant innovations in other product areas as Islamic financiers and scholars have developed, and approved, a variety of other investments. Some of these are listed below:

- Real estate funds: These began as simple residential real estate projects in the USA but have expanded in scope to encompass multi-tenant property both in the USA and in Europe.
- Private equity: This is available, but limited in scope, both by some European laws and by resistance among family-run businesses to such takeover activity.
- Hedge funds: Notable here is the development of approved methods of short selling.
- Repo: The International Islamic Financial Market (IIFM) has entered into an agreement with ICMA to develop an Islamic repo.
- Securitisation: This is being actively considered and, because of its potential importance, is considered in more detail in the following section.

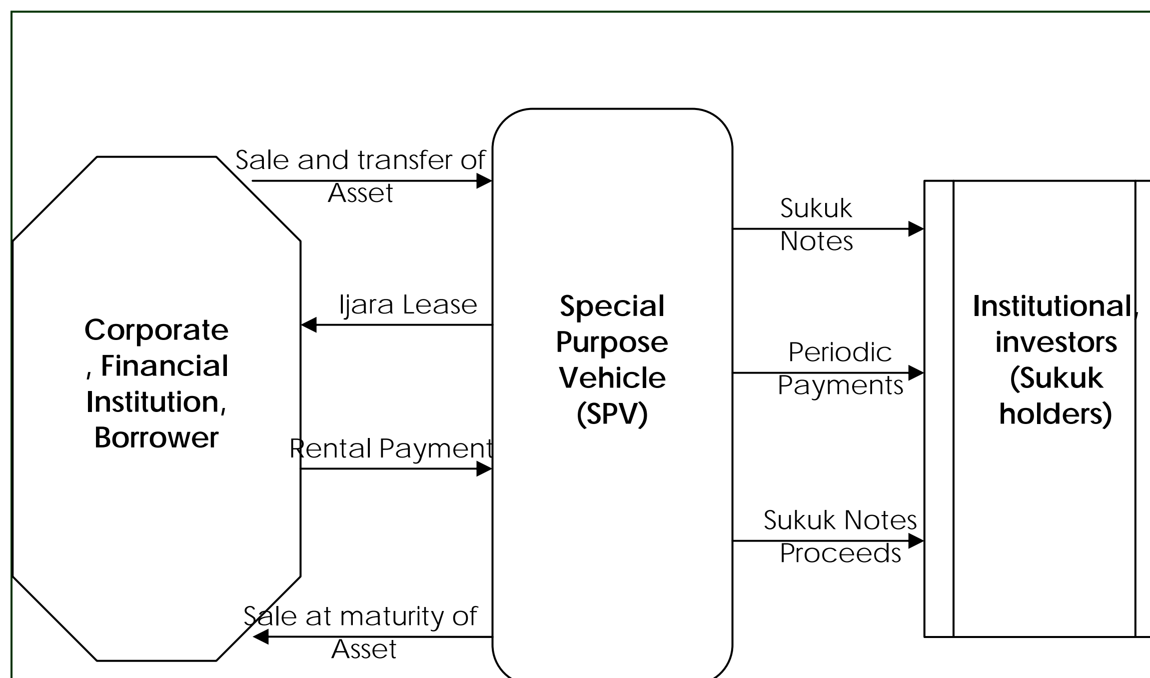
Derivatives are the most prominent example of 'standard' conventional financial products that are generally not permitted, although some jurisdictions outside the GCC (e.g. Malaysia) do allow some forward contracts on commodities; these are not liquid, however, and they are regarded as controversial. Very

considerable effort is being placed into the development of derivative-like risk management tools that can be used by Islamic market participants.

5.2.1 Sukuk and Securitisation

Shariah-compliant asset-backed notes (sukuk) are generally issued by sovereign governments, banking institutions, or corporate enterprises. The commonly used types or structures are: Sukuk al Ijara, Sukuk al Murabaha, Sukuk al Mudharaba, and Sukuk al Musharaka. Figure 16 illustrates the structure of the Ijara sukuk.

Figure 16: The Structure of Ijara Sukuk



An Ijara contract essentially involves the firm transferring ownership on a property to a special purpose vehicle (SPV), that is, a company independent from the firm, set up for the exclusive purpose of holding the asset. The firm then leases the asset back from the SPV, so that it can continue to have the benefit of its use, despite no longer owning it. The payment to the firm for the purchase of its asset would come from the SPV, which would raise the funds by issuing (Shariah-compliant) securities to the public. This structure means that such 'bonds' comply with Islam's prohibition of interest payments.

To date, most issues have been asset-based (that is, with returns derived from those of the underlying assets), but the note holders have recourse to the borrower, rather than the assets, in case of a default. In contrast, asset-backed (or securitised bonds) offer the note holder recourse to the assets themselves, potentially making the debt more attractive, and lowering the cost of borrowing[28].

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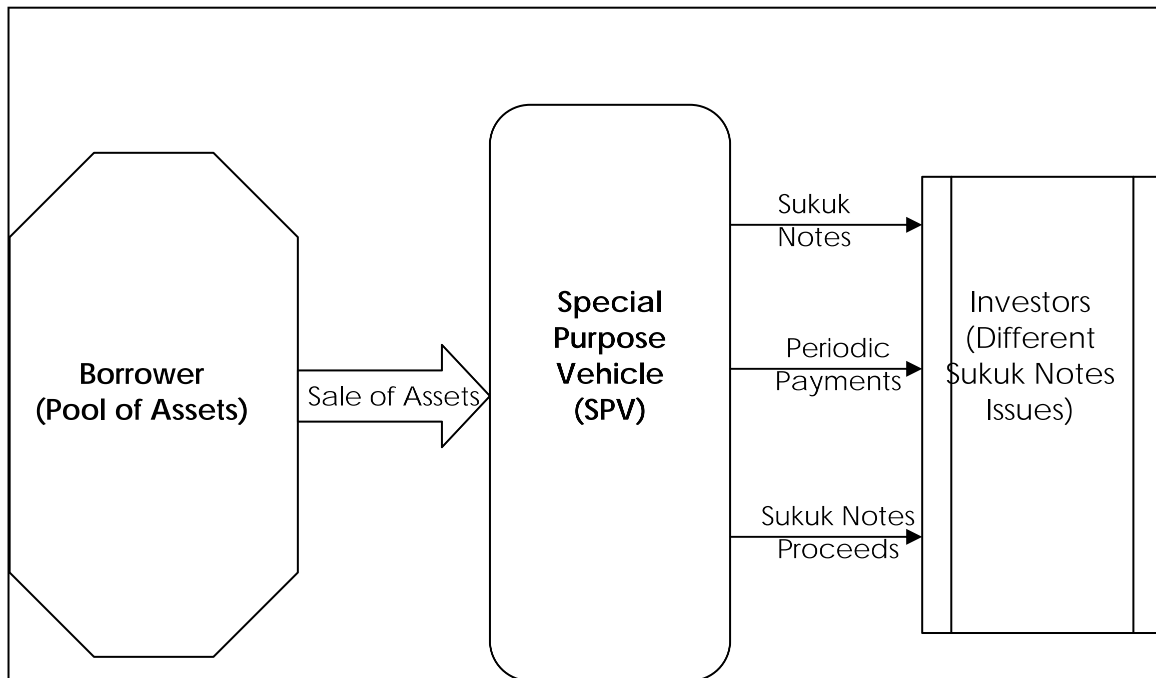
[28] Islamic Bond Report, 2007, *ISI Emerging Markets*, a Euromoney Institutional Investor Company

The assets used in a securitisation can be rated independently of the borrower, giving their bonds a higher debt rating than for the borrower themselves, making borrowing cheaper. Moody's Senior Credit Officer, Phillip Lotter, has stated that "the structure is particularly suited to firms with significant assets, or those hoping for credit enhancement over a lower rating the company itself might otherwise achieve".

Figure 17 shows the basic Islamic securitisation structure.

Figure 17: Basic Islamic Securitisation Structure



A milestone development in the region is the recent launch in the UAE of the Emirates National Securitisation Corporation (ENSC), the UAE's debut into asset-backed securitisation. The firm is a specialised structuring and advisory organisation focused on the securitisation and structured products arena of the international capital markets. ENSC has structured two major asset-backed securities, including the first internationally–rated, residential, asset-backed securitisation issued from the Middle East.

5.3 Structural and Regulatory Issues

The growth and challenges facing the market in Shariah-compliant securities have led international standard setters, national regulatory authorities, law firms, policy makers and academics to examine various aspects of Islamic financial systems and institutions[29]. Focus has been particularly on Islamic financial

[29] *McMillen, M,* Islamic Capital Markets: Developments and Issues, *Capital Markets Law Journal, 2006, vol 1 no 2, pp 136-172*

institutions' (IFI's) risk management practices, the broad institutional environment in which they operate, and the regulatory framework that governs them[30].

As an example, laws and regulations governing land ownership by foreign entities or investors cause great concerns for rating agencies, investors, law firms and issuers alike. The Government of Dubai has made strenuous efforts to introduce new land registry laws that conform to international best practice and cater for local demographic requirements. Similar work has been done in Abu Dhabi, Qatar, Bahrain and to lesser degree in Saudi Arabia.

Equally, international regulators have recognised Islamic finance as a significant factor in Europe, USA and elsewhere in the world. Michael Ainley of the UK Financial Services Authority (FSA) noted that "what is important for the wider acceptance of Islamic banking in developed countries is the harmonisation of standards. The FSA is happy to participate in discussion seeking to reconcile Islamic and Western standards"[31].

There remains considerable debate as to what constitutes Shariah compliance. The differences of opinion seem to centre on whether the compliance aims to meet the spirit of the religious law or merely conform to the letter[32]. For example, sukuks are the most visible form of Islamic finance and in practice they resemble asset-backed bonds. In most sukuks, however, the structure involves ear-marking or hypothecating the assets on the balance sheet – similar to the Pfandebriefen structures used in Germany – rather than the formal transfer of assets to an SPV as in a securitisation. Therefore, in the view of some experts, the conventional sukuks are not Shariah-compliant because the cash flow depends upon the credit worthiness of the issuer rather than the performance of the underlying assets. For them, a proper securitisation of assets would be compliant but none of the GCC countries has legislation to support transfer to SPVs (note that in Dubai the underlying assets would remain under local law even if the financial instruments were created within the DIFC).

This complexity adds to the cost of issuance. As with securitisation, the validity of the process depends upon a third party opinion (for securitisations it is the legal opinion on bankruptcy remoteness, for sukuks it is the religious opinion on Shariah-compliance). In both situations the opinions are expensive to obtain, tend to be non-standardised (with no equivalent of shelf-registration) and so are unique to each issue and add delay to the process; we were quoted 6-8 weeks, which is a long time in bond issuance. Added to this is the shortage of qualified people to give opinions on compliance (with apparently a level of inconsistency in their rulings) and the differences of opinion between Shariah experts.

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30 *Regulating Islamic Financial Institutions: The Nature of the Regulated*, By Dahlia El – Hawary, George Washington University, Wafik Grais, World Bank, Zamir Iqbal, World Bank, World Bank Policy Research Working Paper 3227, March 2004.

31 *Gulf News Quarterly Financial Review* 3, August 2007, Interview with Michael Ainley, the FSA, UK.

32 Muhannad Taqi Usmani, "*Sukuk and their Contemporary Applications*", Mimeo, IIFM, 2008

5.3.1 International Islamic Regulatory Bodies

The rapid growth of Islamic markets and trade in Shariah compliant products can be attributed, at least in part, to the deliberate establishment of a small number of internationally recognised Islamic bodies. These bodies, most of which have national counterparts in western markets, were designed to unify and codify good practice in Islamic finance. Several of these bodies are now well established and are regarded as internationally authoritative. Between them, they offer the prospect, in the short term, of establishing market places for Islamic products that are as well defined and regulated as are the markets for conventional securities.

5.3.1.1 Accounting and Auditing Organisation for Islamic Financial Institutions

The AAOFI was founded in 1990 and has its headquarters in Bahrain. AAOFI issues international standards which are approved both by Islamic accounting bodies and by AAOFI's Shariah board. AAOFI's standards provide uniformity of practice in accounting, corporate governance and ethical matters. In relation to accounting, its standards cover Islamic structures as well as matters that are familiar in 'Western' accounting such as foreign currency translation, reporting of reserves and investment funds.

5.3.1.2 Islamic Financial Standards Board

The IFSB was founded in 2002 and is located in Kuala Lumpur, outside the GCC region. IFSB members are drawn from: sovereign Islamic finance supervisory bodies; central banks and non-Islamic supervisory bodies; international professional associations; some professional and ratings agencies. Among IFSBs objectives are: the provision of regulatory advice; encouraging cooperation between member jurisdictions; facilitating training and research; establishing appropriate participant databases.

5.3.1.3 Fiqh Academy

While this is still to some extent a matter for individual interpretation, at a national, and sometimes transaction level, there are moves to establish at least some uniformity of practice. This arises through the work of AAOFI and IFSB as well as bodies such as the Organisation of Islamic conference (OIC) Fiqh Academy in Saudi Arabia. Clearly, standardisation of interpretation is an important part of the spread of tradable (and cheap to issue) financing vehicles.

5.3.1.4 The Islamic Development Bank

The IDB (located in Saudi Arabia and founded in 1975) acts in a number of capacities, including product development, analysis and education. It also acts, however, as an equity investor and provider of Shariah-compliant funds to member governments for macro economic development.

5.3.1.5 Islamic Liquidity Corporation

This is based in Qatar and acts, in effect, as in investment bank and facilitator of sukuk and other issues. Its function closely parallels that of similar bodies in non-Islamic markets.

5.3.2 Credit Rating and Risk Assessment

GCC corporates as well as government sovereigns have sought issue ratings to meet international standards. Early this year, Moody's Investor Services established their MENA office in the Dubai International Financial Centre (DIFC) and Standard & Poor's is set to make a similar move.

One critical factor is that most rating agencies view Shariah-compliant instruments as no different from their conventional counterparts. For example, Fitch Ratings considers that the majority of risks in sukuk instruments are no different from those seen in conventional bond structures[33]. What matters is whether, for example, the lease obligation in sukuk structures ranks equal to the issuer's other conventional debt obligations[34]. Moody's has a similar view - "The building blocks of finance are the same: Cash flows, Risk, Return, Losses, Contracts, Rights, Obligations, Assets, etc"[35]. Similarly, Standard & Poor's emphasise corporate governance, country risk and ownership structures as vital parts of the assessment process.[36] In its second quarter report, the rating agency raised concerns about the lack of investment risk management among Middle Eastern issuers.[37]

Fitch ratings recently assigned the Government of Abu Dhabi a long-term issuer default rating of AA, just two notches away from the best possible rating of AAA. This made the Emirate the highest-rated sovereign in the Gulf.[38] Likewise, Moody's Investor Service provided significant sovereign and corporate rating services. Table 7 shows the GCC demand for rating while Table 8 lists recent rated corporate issuers in the region.

Table 7: GCC Demand for Rating

Country	Bank	Corporate	Sovereign	Securitisation	Total	New 07
Bahrain	8	1	3	0	12	1
Kuwait	9	1	2	0	12	2
Oman	6	1	2	1	10	3
Qatar	3	6	2	0	11	2
Saudi Arabia	11	3	2	0	16	4
UAE	13	10	3	3	29	12
Total	**50**	**22**	**14**	**4**	**90**	**24**

Source: Moody's Investors Service, 2007

33 Fitch Special Report, *Demystifying Corporate Sukuk*, March, 2007.
34 Fitch Special Report, *Demystifying Corporate Sukuk*, March, 2007.
35 *Rating Shariah Sukuk Workshop*: Khalid Howladar, Vice President, Senior Credit Office, Asset Backed & Sukuk Finance, Moody's Investors Service, DIFX Academy, November, 2007.
36 *Corporate Ratings in GCC*, Peter Tuving, Managing Director, Corporate Ratings, Standard & Poor's.
37 Standard & Poor's, *Middle East Outlook*, Second Quarter, 2007.
38 Charles Seville, Setting Benchmarks for Growth, *Gulf News Quarterly Financial Review* 3, August 2007.

Table 8: Moody's Recent GCC Ratings

Country	Corporate	Rating	Country	Corporate / Government	Rating
Bahrain	Golden Belt 1 Sukuk Company	BAA1	Saudi Arabia	Saad Group Limited	(P) BAA1
				Saad Trading, Contracting and Fin Srv Co.	BAA1
Kuwait	Boubyan Bank	BAA2		Saudi Basic industries Corporation (SABIC)	A1
	National Industries Group Holding NIG	BAA2		Saudi Orix Leasing Company	BA1
Oman	Oman Pwer & Water Procur. Co	A2	UAE	Abu Dhabi Government	AA2
	Bank Dhofar	A3		DIFC Investments LLC	A1
Qatar	Qatar Fertiliser Company (SAQ)	AA2		DP World	A1
	Qatar Real Estate Investment Co.	A2		Dubai Electricity & Water Authority (DEWA)	A1
	-			Dubai Holding Commercial Operations Gr LLC	A1
	-			Dubai Sukuk Centr	A1
	-			EMAAR Properties PJSC	A3

Source: Moody's Investors Service, 2007

Standard & Poor's Ratings Services announced in late September 2007 that it would introduce stability ratings for Islamic banks with profit-sharing investment accounts, or PSIAs. Standard & Poor's expects to issue its initial stability ratings for Islamic banks with PSIA accounts in the first quarter of 2008. The ratings will represent the agency's opinion about the expected stability of cash flow distributable to account holders on a scale running from SR-1, the highest rating, to SR-7, the lowest. The ratings will incorporate analyses of the financial institution's structure and governance, as well as business risk and financial risk profiles. Other Islamic bond issues have been rated; for example, the World Bank issue, discussed in 5.3.5, was rated AAA.

5.3.3 Indices

In October 2007, HSBC bank and the DIFX announced that they would begin producing indices covering Middle East bonds including Islamic bonds. The objective was to boost the Gulf region as an international trading centre for Islamic instruments. One of the indices tracks sukuk, of which some $14 bn are quoted on DIFX. In the absence of active trading activity, however, it is difficult to know whether the index, and in particular the underlying prices on which it is based, will be useful for the purposes for which it is intended. Clearly the

creation of the index by DIFX is in part to challenge London as a potential trading centre. Until trading becomes active, however, the challenge is likely to be nominal.

5.3.4 Inter-dealer broker market

In July 2006, the London IDB, GFI, announced that it would establish an interdealer market for secondary trading in sukuk. Technically this is not difficult, but to date volumes have been low. If, however, the UK Treasury succeeds in its efforts to issue Shariah-compliant government securities, the availability of IDB services will be critical in extending this to enable the creation of a genuine market.

5.3.5 Different Shariah Interpretations

The IIFM is trying to establish some standards for compliant issues, as this would make a substantial contribution to enabling arbitrage between issues, and hence to narrowing spreads between comparable issues and increasing liquidity in the market. The problems surrounding an issue by the World Bank in April 2005 showed that such common standards had certainly not been achieved by that date, however. The World Bank observed;

"The World Bank's 760 million ringgit ($202 million) issue, its first Islamic bond, was forged amid plenty of fanfare in the hope of enticing other global borrowers into the rapidly growing Islamic market and helping to pioneer a truly global marketplace.

The reaction among Arab delegates at the Malaysian conference highlighted differing interpretations of the religious principles behind Islamic finance -- a problem that could impede development of a uniform, global market for Islamic debt securities. The underlying transaction for the World Bank bond is a complicated one and involves the purchase and sale of a financial asset, akin to a certificate of deposit. In Malaysia, where the bond was arranged, this is deemed Shariah-compliant. But the Middle East delegates, and a like-minded manager of Islamic funds from Sri Lanka, said the World Bank issue met none of these criteria because they felt it was based on the purchase and sale of money itself, rather than a Shariah-compliant asset."[39]

If it were possible to agree rules that were acceptable to all Shariah scholars, this would enable the development of a much larger market than at present. Today's market is fragmented due to such differing interpretations and hence different structures and different levels of investor security in an issue. The smaller markets in the Middle East may benefit from such fragmentation, whilst London would benefit from much greater standardisation. This would also lead to finer pricing and lower costs for issuers and investors. As noted above, the international Islamic agencies are well aware of this issue and are collaboratively addressing it in as much detail as is possible.

[39] Source: World Bank Intranet

6 Corporate Governance in the GCC

Corporate governance is a relatively new concept in the GCC region[40]. Typically companies are either state-owned or family-owned. The more substantial family companies are gradually realising the importance of improving governance structures because:

- they want to operate cross-border, which means that greater transparency may be required and different standards of management;
- the second generation of the family have experience of other structures and can see advantages;
- increasing competition is forcing firms to diversify, thus increasing their demands for capital.

Because of this, corporate governance has become a "hot topic" in the GCC. The prime mover in the area is the Hawkamah Institute for Corporate Governance. Hawkamah[41] was founded in 2006 to help countries in the Middle East and North Africa to develop good corporate governance frameworks. At its inaugural conference, it suggested that the Global Corporate Governance Forum Toolkit should serve as the basis for the development of codes within the MENA region. More recently it has been working alongside the Equity Advisory Group (EAG) of the Institute of International Finance (IIF) to ensure that codes in the GCC are consistent with the IIF "Policies for Corporate Governance and Transparency in Emerging Markets". Hawkamah (2007) reports that three of the region's countries (Oman, Saudi Arabia and the United Arab Emirates) have codes in place; the authorities in Bahrain and Qatar are still developing their codes, while a new capital market law in Kuwait will include corporate governance requirements.

It should be noted that banks tend to be Basel compliant and so their governance structures align more closely with international standards than other companies. The state-owned enterprises are generally exempted from governance requirements, and are likely to present problems if they are ever privatised – there is WTO pressure but no expectation of change in the medium term.

6.1 The IIF-EAG Policies for Emerging Markets

The IIF policy[42] includes five main categories of corporate governance and contains recommendations for companies, exchanges and company law:

- The protection of minority shareholders. Protection would operate through a one-share one-vote system, with proxy voting available to both

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40 For a summary of current issues in Corporate Governance, see for example: Mallin, C. A. (2007) "Corporate Governance" Oxford University Press

41 http://www.hawkamah.org

42 Institute of International Finance (2003) "Policies for Corporate Governance and Transparency in Emerging Markets" Institute of International Finance

domestic and foreign shareholders. Shareholders should vote on all transactions involving a change to the capital or ownership structure of companies, and would receive all agenda items for shareholder meetings at least one month before the meeting.

- The structure and responsibilities of the board. Boards would be comprised of at least one third non-executive directors, the majority of whom would be independent. Those independent directors should chair the compensation and nomination committees, and should serve three year terms.
- Accounting and auditing. Companies' accounts should be consistent with either IAS or US GAAP, the audit committee should be chaired by an independent director, and at least one of the independent directors on the board should have relevant experience in accounting and finance.
- Transparency of ownership and control. Transparency of ownership and control would be achieved through publication of all directors' holdings, individual holdings between 3 and 10% and of connected party holdings of 5-10%. A holding of 35% should trigger a buyout.
- The regulatory environment. The regulatory environment should be one in which exchanges, regulators and political parties are independent of one another.

If fully implemented, the policies would move corporate governance in emerging markets very swiftly towards the same standards as the Anglo-Saxon system[43].

In 2006, the Hawkamah Institute together with the IIF carried out a survey to discover how closely the countries in the GCC region adhere to the framework. The respondents were regulators, officials from the central banks, auditors and investment firms. Compliance was ranked on a scale of 1-5, with 5 indicating full compliance. The results are tabulated in Table 9 and charted in Figure 18.

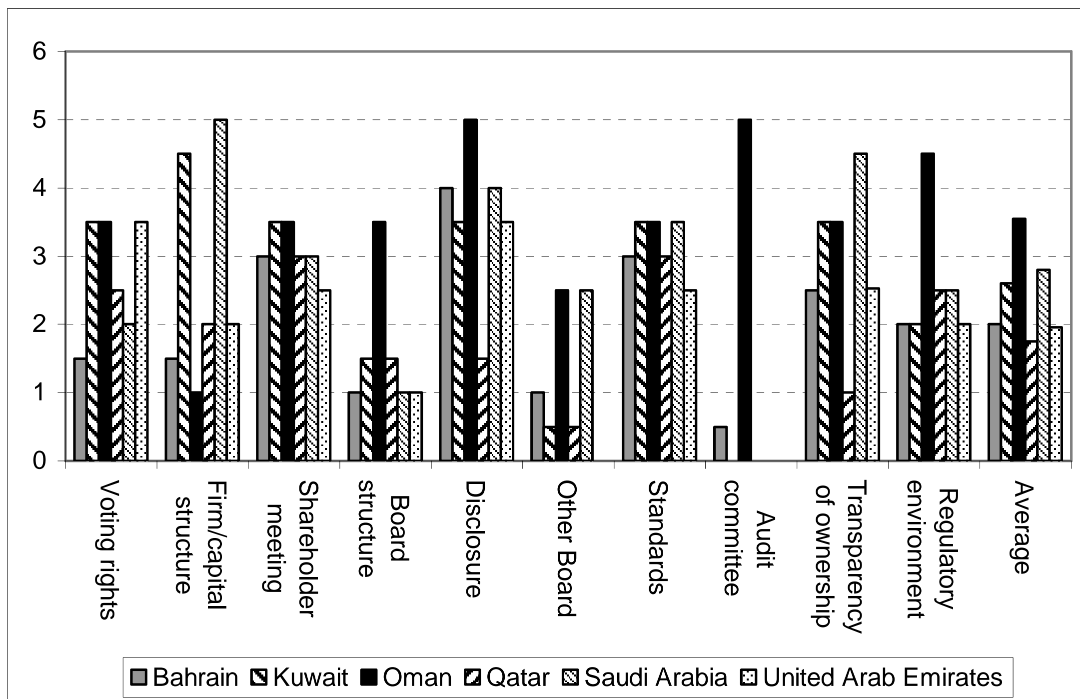
[43] Financial Reporting Council (2006) "The Combined Code on Corporate Governance" Financial Reporting Councilor

Table 9: Corporate governance in GCC

	Bahrain	Kuwait	Oman	Qatar	Saudi Arabia	UAE
Minority shareholder Protection						
Voting rights	1.5	3.5	3.5	2.5	2.0	3.5
Firm/capital structure	1.5	4.5	1.0	2.0	5.0	2.0
Shareholder meetings/other rights	3.0	3.5	3.5	3.0	3.0	2.5
Board Structure and responsibilities						
Board structure	1.0	1.5	3.5	1.5	1.0	1.0
Disclosure	4.0	3.5	5.0	1.5	4.0	3.5
Others	1.0	0.5	2.5	0.5	2.5	0.0
Accounting and auditing						
Standards	3.0	3.5	3.5	3.0	3.5	2.5
Audit committee	0.5	0.0	5.0	0.0	0.0	0.0
Transparency of ownership and control	2.5	3.5	3.5	1.0	4.5	2.53
Regulatory environment	2.0	2.0	4.5	2.5	2.5	2.0
Average Score	**2.0**	**2.6**	**3.6**	**1.8**	**2.8**	**2.0**

Source: Institute for International Finance and Hawkamah Institute for Corporate Governance, 2006

Figure 18: Corporate governance survey results



Source: Source: Institute for International Finance and Hawkamah Institute for Corporate Governance, 2006

The Sultanate of Oman introduced its Code of Corporate Governance in 2002, making it the first country in the region to have a formal statement of governance principles. It is therefore not surprising that the IIF-Hawkamah survey of 2006 indicates that it is the most compliant with the guidelines. Oman's overall score is 3.6, with impressive scores of 5 for disclosure on board-related issues and for the audit committee. As Table 9 indicates, Saudi Arabia is the only other country to be fully compliant with any individual aspect of the IIF guidelines, but it still averages only slightly over 50% overall. Comparing Oman's scores with those of the other GCC countries, there is only one area in which its corporate governance is deemed less compliant that than of its neighbours. This relates to shareholder approval of changes to capital structure and on merger activity, where Kuwait has better compliance. It seems reasonable therefore to use Oman as the model of best practice in the GCC region; it is therefore discussed in more detail in the following sections.

6.2 The Situation in Oman

The Muscat Securities Market was founded in 1988. Ten years later the capital market law was updated, and in 2002 the Code of Corporate Governance was put in place[44]. The Code regulates the governance of the 154 companies now listed on the Exchange. The Code contains 28 articles and four schedules covering the principles of corporate governance, the type of information to be provided to the Board, the role of the audit committee and a list of items to be included in the report on corporate governance provided to shareholders. That report must highlight any areas of non-compliance with the code, offering reasons for the deviation.

The Board is required to be made up of a majority of non-executives, with at least one-third being independent. The Code gives a full definition of independence, which is consistent with international best practice. The roles of Chair and CEO must not be held by the same person, but there is no indication that the Chair should be a non-executive or an independent director. The Code goes into some detail on the role of the Board and the number of meetings it should hold each year. It states that the Board should nominate members of sub-committees, but provides specific details only on the audit committee.

In line with best practice in other countries, the audit committee should be made up of non-executives, with the majority being independent. At least one member should have relevant, specialist knowledge of finance. Unusually, there is considerable focus on related party transactions, and the role of the audit committee in determining their suitability and reporting on them to the shareholders. This may reflect the nature of the business culture in the area. The firm's accounts must comply with International Accounting Standards, and the auditors must be independent, in that they cannot simultaneously provide non-audit services to the firm. The Code also includes good disclosure requirements.

In common with other codes, there is some discussion of directors' remuneration, although it is not clear how policies on remuneration are set. Each company's report on corporate governance must include the details of the remuneration of

[44] Central bank of Oman and Capital Market Authority (2002) "Code of Corporate Governance for SAOGs"

all directors and the top five executives. There is a clear indication that remuneration reporting should include performance-related elements including bonuses and stock options.

While this code represents a major step forward, it fails to meet the IIF requirements for governance in emerging markets. There is a particular issue over the protection of minority shareholders' rights, a subject that is not mentioned in the Code. The IIF is also committed to the creation of nomination and compensation committees. The role of the nomination committee is to ensure that new board members have appropriate skill sets and experience, so that each time the board is refreshed it remains balanced. The compensation committee, rather than the main board as appears to be the case in Oman, should determine the right mix of performance-related and other components of remuneration for the executive directors.

Whilst Hawkamah is working closely with regulators and companies in the GCC region, there is clearly some way to go before effective governance rules are established, and, crucially, enforced in the region.

6.3 Comparison with the UK

The fact that Oman has issued a code, together with the "comply or explain" approach to implementation, invites direct comparison with the system in the UK, rather than the US where corporate governance is regulated by law.

The codes in the UK and Oman are very similar with respect to board composition and structure, and in the composition and activity of the audit committee. Key differences arise in the areas of other sub-committees and the specification of relationships between the firm and its shareholders. The UK Code requires each company to have remuneration and nomination committees as well as an audit committee. It also puts the onus on financial institutions, as shareholders, to take their duties as owners seriously.

Oman's code goes into detail in describing the nature of independence as it relates to non-executives, and states that the corporate governance section of the annual report must explain how the directors were nominated; it is silent, however, about the nomination process. This is despite the fact that the principles of corporate governance state that shareholders may elect any candidate even if the board has not itself recommended that person. Similarly, whilst the reporting requirements on directors' remuneration are clear and comparable with those in the UK, it is unclear who determines the composition of remuneration packages. The guiding principle states that the company should develop policy in this area, implying that the decision could be made at sub-board level, or by the affected board members. These are substantial omissions and allow for a great deal of discretion on the part of individual boards.

The UK Code emphasises the importance of the AGM as a forum for communicating with shareholders, but also includes a separate section on the importance of more regular dialogue with institutional shareholders. The focus of Oman's code is on communication through the annual report, although it states that general meetings are a good way of communicating with shareholders. It makes no specific mention of an AGM, or of the procedure for calling other

general meetings. Whilst it includes the principle that companies should be ready to enter dialogue with institutional owners "where practicable", it makes no suggestions as to how this would be achieved or the circumstances in which it would not be practicable.

To summarise, Oman's code initially appears reminiscent of the UK Code, and indeed is so with relation to the composition of the main board and the audit committee. It differs with regard to other important areas, however, such as board succession planning, remuneration and shareholder involvement. These are specified in much less detail, where at all, suggesting that individual companies have a great deal of freedom in their operations with regard to these very important aspects of governance.

7 Enhancing London's Position and Meeting the GCC Challenge

While London is "home" to the shares of many overseas companies, currently just three companies from the GCC region have a listing in the LSE's main market, and none are listed on AIM. The Arab Insurance Group (Bahrain), the Bank of Muscat and Qatar Telecom all have depositary receipts traded in London. London is keen to promote its position as a centre for the creation and trading of Shariah-compliant investment products, however. If the City can become an important centre for trading "debt-like" securities then large, established companies from the GCC region may choose to promote their international reputation by listing in London rather than elsewhere. Given the relatively small number of companies listed in the GCC exchanges and the availability of liquidity in the region, however, it is not obvious that, in the short term, companies from the region will seek overseas listings.

As corporate governance in the GCC becomes more rigorous, the reputational benefits of an overseas listing will become less compelling, meaning London will need to offer a range of additional benefits in order to attract business from this region.

7.1 The development of London as the major centre for the issuance and trading of Shariah-compliant issues

While Shariah-compliant finance in the UK and other countries has previously been substantially in the form of retail products, the wholesale market in Shariah-compliant products is now also growing and is potentially very large – and therefore attractive to participants in international markets. At present, the total market size is estimated at only $500bn[45], which in global terms is relatively small. This is also small in relation to the volume of funds that might be attracted to compliant issues, especially in an environment in which an increasing proportion of institutional investors in Islamic countries are seeking such products.

The UK government has indicated its desire to establish London as the major centre for international capital seeking to invest in Shariah compliant financial instruments. Other major centres are also trying to establish themselves as the centre of Islamic finance, however, in particular Dubai and also Kuala Lumpur. If the UK government were to succeed, the Shariah market would join the international capital market (formerly the Eurobond market) as a market which developed in London and acted as an 'entrepot' for global capital. The London Stock Exchange has made a start by listing a number of such issues and has also been the market chosen by Barclays' i-shares for the listing of their exchange traded funds (ETFs) which invest in Shariah-compliant products. David Shrimpton, Head of Product Management and Development at the London Stock Exchange, has noted that:

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[45] Source: FT "West's first Islamic bonds face legal issues, Oct 7, 2007

"The range of Shariah compliant products listed on the London Stock Exchange's main market continues to grow. In the past year and a half we have admitted 14 Islamic finance instruments, or sukuk, to trading on our markets, which have raised in excess of £5 billion."[46]

The UK, and London in particular, is the major centre for international finance in Europe and thus is one of the potential locations for such a new market. Only New York could be considered to be in the same global financial centres league, though somewhat smaller, in international finance. There have been no sukuk issues in the United States, however, and given the political questions that such issues might raise it is less likely that New York would become such a centre. Dubai is the major listing centre for existing sukuk issues but turnover figures are not readily available from DIFX; it may be assumed that most investors are buy and hold and that exchange turnover is therefore low.

In order to evaluate the feasibility of the development of a true market in London, or in other financial centres, we consider here what it is makes a true wholesale market in corporate issues, rather than just an ad-hoc issuance location or location for stock exchange quotations. The key features of active markets include:

- benchmark pricing provided by large government issues;
- availability of ratings from major bond rating agencies;
- secondary market trading and liquidity;
- availability and transparency of secondary market prices;
- availability of reliable and published indices;
- transparency of underlying issuers in respect of accounting and corporate governance;
- the availability of a repo market in the instruments concerned;
- an inter-dealer broker (IDB) market between dealers;
- certainty of legal aspects of documentation and prospectuses including perfection of title in the case of sales to special purpose vehicles (SPVs);
- availability of a master agreement for documenting Shariah-compliant issues;
- widespread agreement by Islamic investors that issues do comply with Shariah law;
- investment in such instruments by investors from a wide range of Islamic and non-Islamic countries.

While it is true to say that corporate bonds in many countries are not highly liquid, there is little chance of a corporate market developing at all unless there is a widely traded and highly liquid government bond market. This is because corporate bonds are priced in relation to government bonds in the same currency by quoting a (credit) spread over the equivalent maturity government bond. If government issues are not available, it is much less likely that an active corporate issue market will develop. To address this, the UK government has indicated its desire to issue government securities in sterling in sukuk form, which would provide a basis for active trading and for pricing of corporate securities. Not only would this provide a market from which to price, it would also establish

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[46] LSE website

a structure that could be replicated by corporate issuers and thus reduce the costs of making such issues.

7.1.1 UK policy statements

In June 2006, the then Chancellor of the Exchequer, Gordon Brown, announced in a speech to the Muslim Council of Britain that "Britain was well placed to achieve a role as the gateway to Islamic finance and trade". In April 2007, Ed Balls, the then City Minister announced that the Treasury was paving the way for the launch of the first Shariah-compliant UK government bonds, no later than 2008. Currently the only governments which have issued such bonds are those of Pakistan and Malaysia. The issue of such bonds would not only allow the development of a wholesale market in Shariah-compliant instruments in the City of London, but would also allow the government owned, National Savings and Investment (NS&I), to issue Shariah-compliant retail savings products based on the underlying wholesale instruments. These would be available to Muslims and non-Muslims through the nationwide retail outlets of the Post Office and via major banks.

At the time of this announcement, the Chancellor recognised the difficulties involved in creating a viable market in UK government Shariah-compliant bonds. First, the cost would be higher, if only because of the costs of legal and religious advice that would be necessary to ensure that the first issue met the needs of both the government and those wishing to acquire compliant assets. The market might also demand a yield a few basis points higher than that on straightforward gilt.

By October 2007, doubts were beginning to arise over the complexities of such an issue. In particular, it was appreciated that legislation would have to go through Parliament to make issuing practicable. Producing such legislation would require substantial time in Parliament, negatively impacting on the time available for other legislation on the Parliamentary agenda. In addition, there were concerns that without a substantial premium, buyers might not be interested. Finally, in October, Mr Balls changed job and became Schools Secretary, and it is unclear whether his successor, Kitty Ussher, has these issues on her agenda in the same way.

In November 2007, the Treasury Debt Management Office issued a paper entitled "Government sterling sukuk issuance: a consultation". The purpose of the paper was to seek views on the advantages, disadvantages and risks of HM Government becoming an issuer of Islamic financial instruments, as well as gathering feedback from potential issuers, intermediaries and investors as to factors that were important to them. In addition, there were a number of specific technical areas relating to issuance on which the paper sought guidance. Most importantly, the paper set out the Government's objective for Islamic finance. It clarified two key purposes – first, "*to entrench London as a local gateway for Islamic finance*" and second "*to ensure that all British citizens, regardless of their faith, have access to competitive financial services*". These two matters go hand in hand, since without an active wholesale market in sterling products it is much harder to create competitive retail sterling products.

7.1.2 Current UK position

The government has already started a feasibility study in order to determine the factors which might cause difficulty with the proposed issue. This identified:

- the need for primary legislation;
- the need to identify specific assets such as buildings which could be transferred to a special purpose vehicle (SPV) to facilitate sukuk issuance;
- the issue of taxation treatment of assets when transferred to and from the SPV and any other taxation or regulatory issues.

The Treasury is considering two types of issue – a 'bill like' issue and a 'bond like' issue, the former having a maturity of less than a year and possibly as short as three months, and the latter potentially 5 years. The bond like issue would be held principally by long-term institutional investors, while the bill like issue would also offer Islamic banks the advantage of being a Shariah-compliant financial instrument which could be used for liquidity management and would also be likely to be widely traded. The availability of such an instrument would make it easier for Islamic banks to expand within the UK (and elsewhere) and hence to expand their offerings of Shariah-compliant retail products.

The consultation period ended on 21st February 2008 and the government has now requested written responses to the questions raised in the paper, which are mainly technical in nature. Difficulties are more likely to arise in connection with finding Parliamentary time for any legislative changes required. The first structural issue that has to be determined is the type of contract that would be used. The government has assumed that it would be a Sukuk al-Ijara (using a lease contract) rather than a Sukuk al-Mudaraba (based on partnership) type of contract. It is, however, worth noting that this type of contract is similar in many ways to the structure of collateralised debt obligations (CDOs) which have recently been an area of public concern due to the collapse in the value of the underlying collateral (residential property mortgages) in many CDOs; this has been an important element in the current credit crunch.

It is appropriate that in its consideration of such fund-raising, the Government has been duly concerned with trying to ensure that its own issues create a structure which can be replicated by corporate issues. Without this replicability, there would be much less value in creating Government issues, since a key Government objective is to facilitate the development of a wholesale market in London which would comprise UK and overseas corporate bonds. The Government is thus planning to ensure that, if there were any differences between sukuk issuance and traditional bonds and bills that could affect investors adversely or make corporate replication difficult, then such differences arising purely from regulatory, taxation or listing treatment differences would be addressed by appropriate measures.

7.1.2.1 'Bill-like' sterling sukuk

Islamic financial institutions worldwide are unable to use traditional liquidity management instruments such as the interbank market or treasury bills, since

these involve interest payments. This causes liquidity problems for these institutions which Abdul Rais Abdul Majid[47] summarises as:

- the small number of participants;
- the slow development of Islamic financial instruments;
- non-Islamically acceptable interbank market;
- the absence of a liquid Islamic secondary market;
- no lender of last resort facilities;
- different Shariah interpretations.

The most common solution to liquidity management problems is to use commodity murabahah. This is a form of short-term finance based on the murabahah contract and generally used for trading in commodities. Such an approach is both limited in application and subject to different interpretations, however. If the UK Treasury were able to create an Islamically acceptable alternative, this could be used for liquidity management, not only in the UK but, in combination with currency swaps, in other currency regions. While the UK government is moving ahead with this project, so too is the International Islamic Financial Market (IIFM), established in 2001 by the Governors of the Central Banks or Monetary Agencies of Malaysia, Bahrain, Indonesia, and Sudan, and the President of the Islamic Development Bank. The IIFM's main objectives[48] are:

- to spur the establishment and development of an international financial market based on Shariah rules and principles;
- to address the issue of liquidity management in Islamic banks;
- to develop an active secondary market, which is at the core of its mission;
- to create the environment that will encourage both Islamic and non-Islamic financial institutions to actively participate in a secondary market.

To date, the IIFM does not seem to have achieved the majority of its objectives. Part of the difficulty is due to different interpretations of Shariah law and hence of the acceptability of different financial instruments which might be developed. This is a problem from which the UK's attempts at creating such instruments could also suffer. The UK does not have to have multi-country agreement on the acceptability of the instrument so created, however, so it will be for any individual financial institution to decide whether or not to use an instrument, rather than needing approval from a committee comprised of individuals from different countries.

The IIFM has now signed Memoranda of Understanding with both the International Swaps and Derivatives Association (ISDA) and with the International Capital Markets Association (ICMA). The ISDA agreement was signed in September 2006 in order to form the basis for developing a master agreement for documenting privately negotiated Shariah-compliant derivatives transactions. As the ISDA press release notes:

> *" unlike their conventional counterparts, Islamic financial institutions (IFIs) have at their disposal a limited range of 'allowed' investment instruments,*

47 Abdul Rais Abdul Majid, CEO International Islamic Financial Market (IIFM) speaking at a conference on Islamic Banking: Risk Management in Jakarta, October 2003

48 Source: Abdul Rais Abdul Majid op.cit.

particularly hedging instruments, a key use of derivatives. This constraint has hindered the development of an efficient and active Islamic financial market. The limited risk management options available to IFIs makes them less competitive and most importantly, affects their profitability."

The ICMA Memorandum of Understanding was signed in January 2007 with the purpose of co-operating:

> "*through joint working groups in developing market practices, documentation and educational and technical services for the Islamic capital markets.*"

The press release notes in particular that:

> "*standardisation and uniformity are critical to the further growth and advancement of the Islamic Financial Services Industry (IFSI) and to the Islamic capital and money markets in particular.*"

The working groups will focus on projects such as sukuk issuance recommendations, a master agreement for Islamic repo-style transactions, a trade matching and reporting system compatible with Shariah-compliant instruments, and educational offerings.

The press release emphasized the importance of education in helping to expand the Islamic Financial Services Industry. A number of educational bodies are now examining how to expand such educational provision. For example, the ICMA Centre at the University of Reading, is now about to offer an MSc programme in Financial Markets and Islamic Finance. This will the first such degree in the UK taught in collaboration with a specialised Islamic finance university based in an Islamic country.

7.1.2.2 'Bond-like' sterling sukuk issuance

A key question in the issuance of longer term securities is the extent to which they are different from or similar to conventional gilts apart from the extent to which they are Shariah compliant. Thus their 'yields' could be the same, even though returns on them are not considered to be interest. It seems likely that the Treasury hopes that for non-Islamic investors such securities would be interchangeable with conventional gilts, and thus demand for them would come from both non-Islamic and Islamic investors. Without such, in effect, 'fungibility', it is unlikely there would be sufficient secondary market activity in such issues and, as a result, they would tend to trade at a liquidity premium. If this were the case, then basing pricing of corporate bonds on such secondary market prices would be more complex. It would also clearly be important from the Government's point of view that, apart from the higher initial structuring costs, such issues should not impose a heavier burden on the Treasury than conventional issues.

7.1.3 The 2008 Budget announcements

The UK government's commitment to Islamic finance in regard to the eventual issuance of a debut sovereign benchmark sukuk bond was reinforced by the Chancellor of the Exchequer during his 2008 Budget. In this, he announced that

the Government remains committed to assessing the feasibility of issuing a sovereign sukuk.

The announcement was tempered by the view that "tax, regulatory and value-for-money considerations" meant that no final decision had been taken, but that the government would take legal powers in the Finance Bill 2008 to facilitate a future sovereign issuance. In addition, the Government has announced plans for further legislation in 2009 to equalise the treatment of conventional and alternative (including Islamic) financing arrangements. Irrespective of the eventual volume of Islamic products, these developments confirm the desire for London to be the home of an eventual Euro sukuk market.

In addition, it has been noted, but not confirmed that a number of blue chip British corporates are planning substantial sukuk issuances during late 2008 or early 2009.

7.2 Islamic banks in London

The major investment banks and commercial banks have Islamic financial services departments, which are likely to be major beneficiaries if the UK Government succeeds in establishing a Treasury market in Islamic securities. They are likely to be active both in expanding the range of retail products and in facilitating corporate issues through the operation of an 'Islamic window' or through subsidiaries. There are, in addition, specialised Islamic financial services firms in London:

- The first to be authorized by the Financial Services Authority was the European Islamic Investment Bank (EIIB), which was incorporated in January 2005 and received authorisation from the FSA in March 2006. In April 2006, EIIB opened for business, and in May 2006 completed its IPO and was admitted to London's AIM market. In November 2006, EIIB opened a representative office in Bahrain.
- The Islamic Bank of Britain is a retail financial services institution also authorized by the FSA.
- The most recent independent bank is the Bank of London and the Middle East, which offers a full range of investment banking services. Kuwait's Boubyan Bank owns 20% of it.

Whilst such banks are clearly relatively small in comparison to the major London international banks, their establishment is an indication of the expected importance of Islamic finance; it is also worth noting that London currently has more activity in this field than the rest of Europe combined[49].

7.3 Links between GCC exchanges and other markets

In keeping with the perception of the growing importance of the GCC financial markets, a number of significant alliances between established non-GCC exchanges and GCC markets have been established.

[49] Source: FT, Wholesale Islamic outlet is London's second, July 08, 2007

7.3.1 Borse Dubai and NASDAQ

On 27th February 2008, Borse Dubai entered a series of transactions with NASDAQ, under which it acquired control over some 60 million shares in NASDAQ, while NASDAQ obtained a one-third interest in Borse Dubai.

As part of the transactions, NASDAQ, OMX and Borse Dubai entered into a technology licensing and marketing agreement that allows Borse Dubai access to the technology platforms and proprietary systems of NASDAQ and also gives permission to use NASDAQ trademarks and name in relation to the DIFX business in certain territories[50].

7.3.2 Development: LSE and QSE

On 8th March 2008, The London Stock Exchange (LSE) chose Qatar as its main Gulf partner. One critical factor in the Qatar/LSE deal was the relationship between Borse Dubai and NASDAQ, which ruled out any long-term collaboration with Dubai (despite Borse Dubai's 20 per cent share in the LSE – which it is intending to sell to Qatar).

Their impending deal will involve the LSE supplying services and technology to further develop the Doha Stock Market as a regional trading centre. LSE will provide systems and technology to enhance the Doha operation, as part of a normal commercial relationship between the two exchanges. This announcement leaves open the possibility of a deeper relationship, perhaps with dual listings in Doha and London, and possibly developing London's access to the substantial liquidity in the Gulf.

7.3.3 Implications

The implications of these alliances have yet to emerge. At one level, however, they render the issue of a single winner redundant as the fortunes of all alliance members are so closely linked. Equally, they reflect on the broader issue that the increasing competition between London/European exchanges and their US counterparts will have an effect on the intra-GCC positioning that was discussed in earlier chapters. It is quite possible that the impact of the political issues that the US government has with some Muslim countries will mean that the European axis will be dominant in the future. If so, this would mean that Doha is in a better position to become a major market centre than Dubai. Also, as London is currently held to be the principal international financial centre, the close links between Doha and the LSE could prove advantageous for both Qatar and the UK.

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[50] At time of writing there was breaking news of an alliance between the Abu Dhabi Securities Market and NYSE/Euronext

8 Conclusions and Key Issues

8.1 Challenges for Gulf States

8.1.1 GCC development needs

The GCC states see a need to diversify their economies away from oil. For some, their remaining oil supplies are limited; for others, a growing population needs employment. For others still, their oil revenues are seen as an opportunity to fund and develop a local infrastructure. Financial services are relatively under-developed in the region and all the States view developing this sector as important.

The GCC states are capital exporters and their domestic corporate base is small – partly because of extensive state ownership and partly because of a reliance on family companies. Both of these situations are changing, but it remains true that the economies themselves are still very small, with the exception of Saudi Arabia. Therefore, unless they are able to attract external business, their domestic financial markets are unlikely to develop significantly. This is compounded by other issues discussed in the following sections.

8.1.2 Human capital

Human capital is critical for all financial centres and the lack of availability of appropriately skilled staff is a common weakness in emerging economies, especially with regard to regulatory staff. This is also true of the Gulf States, where the problem is compounded by large government sectors and a general preference amongst citizens for work in other parts of the government sector.

All of the Gulf States, and particularly Bahrain, Dubai and Qatar, have been happy to invite large numbers of expatriate workers into their countries; they have also made their countries increasingly attractive places to work, for example, by reducing restrictions on property ownership. There are some "localisation" policies but the realities of the situation mean these are generally not pursued.

To develop a fully fledged financial sector will, however, require greater involvement of the local workforce to occupy management positions in banks, mutual funds, stock brokers and similar institutions. There is currently, however, a chronic shortage of suitable local educational and training opportunities for the financial sector.

A specific area of skill shortage is in Shariah scholars with financial expertise. Islamic financial instruments need to have approval from such scholars, and the rapid development of Islamic finance is putting strains on the current supply.

8.1.3 Financial and business environment

The financial and business environment (for example, legal structures, business freedom, tax, and infrastructure) is crucial to the success of a financial centre. In general, the Gulf States do not score well on measures of the business

environment. Although they score highly with regard to tax levels, in other areas which consider issues such as the high level of government involvement, levels of corruption, and unclear property rights, they score comparably with other developing markets in the region. Bahrain scores more highly than the other States, although this is not a large difference.

Some of the Gulf States do score more highly as business centres, however. Indeed Dubai, Qatar and Bahrain are three of the only seven developing market centres that rank in the top 50 in GFCI 3 (along with Shanghai, Mumbai, Johannesburg and Beijing). Although Dubai ranks significantly ahead of the other Gulf centres in the GFCI, all three centres are improving, and are expected to continue to improve, their ranking. These results suggest that the creation of financial centres in Qatar and Dubai has enabled them to create a more conducive environment for their financial sectors, above the general business environments in the countries.

8.1.4 Wealth and asset management

The Gulf region is home to about 60% of global sovereign wealth fund (SWF) investments. SWFs are expected to grow rapidly, and their influence is expected to rise – one estimate is that they will reach $12trn by 2015[51] (from $2.5trn in 2006). The growth of Gulf SWFs is causing them to seek a wider range of assets, and also to act more like long-term institutional investors. The Gulf SWFs are, however, unusually opaque in their investment policies; this may cause issues in countries which are unhappy with large non-transparent organisations taking strategic positions. These factors suggest that the Gulf SWFs may need to change their investment approach towards higher transparency and more direct involvement in management.

Traditionally, the private asset management business was a private banking structure, which directed oil revenues into property in Europe and US government bonds - although recent years have seen some diversification into equities. A number of factors are likely to change this situation, including the growth of wealth, local infrastructure needs, the development of local capital markets, political disquiet in the recipient countries, a desire for Islamic investments, and the beginnings of a wider distribution of wealth.

These factors are likely to lead to:

- a widening of the range of assets away from property and US Treasury bonds;
- a stronger focus on local investments – although the Gulf will remain a substantial exporter of capital, as local markets are constrained by the size of the local economies;
- a rising demand for Shariah-compliant investments;
- a greater demand for retail products targeted at the moderately rich, such as mutual funds.

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[51] *How big could sovereign wealth funds be by 2015?,* Morgan Stanley (May 2007)

8.1.5 Corporate governance

The dominance of government-controlled and family-controlled firms in the GCC region has not promoted the development of good standards of corporate governance by international standards. A number of factors are changing this, however:

- companies want to be able to operate cross-border, which means that greater transparency may be required and different standards of management;
- the second generation of family-run enterprises have experience of other structures and can see their advantages;
- increasing competition is forcing firms to diversify and so increasing their demands for capital.

Current standards of governance do not always conform to internationally accepted levels; survey results from Hawkamah indicate a generally low level of compliance with internationally accepted norms of corporate governance.

There are, however, encouraging signs that the factors described are leading to improvements:

- three of the Gulf countries – Oman, Saudi Arabia and UAE – have codes in place;
- the Omani code, while somewhat less stringent than, for example, the UK model, has led to a significant improvement in compliance. Oman scored 3.6 out of 5 in the Hawkamah survey, compared to a GCC average of 2;
- both the DIFC and the QFC have adopted governance standards and Qatar intends to extend those standards nationwide when the regulatory merger takes place in mid-2008.

8.2 Emerging financial centres

The local capital markets display a number of common features:

- With the exception of Saudi Arabia, all are relatively small; the collective market value of the markets excluding Saudi Arabia is around £200bn. There are few listed companies – less than 400 including Saudi Arabia. Finally the free float of listed companies is generally low – most have large government or family holdings.
- As a consequence of this, most of the Gulf markets are relatively illiquid, with turnover ratios below 50%.
- Regulation and corporate governance standards do not conform to international standards; there is little effective regulation of market abuse.
- Markets are largely speculative and driven by individual investors – many of whom are extremely wealthy and can affect the market with their trading.
- Markets have displayed high levels of volatility, especially in 2006.

In addition, the exchanges are owned and operated by government ministries (as are the regulators). This has typically meant that infrastructure development has been rapid, but that regulatory and product development has been slow.

Saudi Arabia is the largest market in the region, by a considerable margin. It has a sophisticated infrastructure, but remains largely separate from the global financial system. As a domestic market it will clearly gain significance as an investment destination but it is unlikely, on current trends, to attract international capital market business.

Bahrain has traditionally been the offshore banking centre for the region. Its banking sector remains very large in relation to its economy, and major international banks are present in Bahrain. Its banking sector is now smaller than that of Saudi Arabia and the UAE, however, indicating that developments in other States have enabled them to catch up. Similarly, Bahrain's lead in wealth management has been eroded by developments in other states. Finally, its capital market is extremely small. The question for Bahrain is whether it can continue to develop its financial sector based upon a narrow range of products when other centres offer a wider range.

Dubai and Qatar have opened international financial centres (DIFC and QFC). These are distinct from the domestic economy and offer international standards of regulation and internationally acceptable legal systems. The two centres are still very new but it is possible to draw distinctions in possible success factors between them:

- The Qatar Financial Centre has a much closer integration with its domestic capital market than Dubai does; a merger of regulators is planned this year, meaning that the market will gain from having a base of companies (albeit a small base). It also has domestic capital market needs to raise and allocate funds for large infrastructure developments, so there is a natural domestic market.
- Dubai has long needed to diversify its economy and has a strong track record of achievement in developing alternative, outward-looking, businesses and attracting international players. Its financial centre is much better known globally than that of Qatar. However its explicitly exchange-based and internationally focussed model has struggled to attract listings, and as the DIFC is geographically separate from the rest of Dubai, integration would be difficult.

8.3 Islamic finance

Islamic finance has experienced very fast growth since its "emergence" in the 1990s. Current growth is often estimated at between 15 and 30% per annum – admittedly from a very small base. By many estimates, the market is currently at some $50bn per year and rising. In contrast, the global market for non-Islamic issues is some $2tr per annum – some 40 times larger.

Islamic issuers and markets have recognised the need for, and benefits of, standardisation of products and certainty of interpretation – both of which were lacking in the earlier years. A series of international bodies has been established with the explicit remit of achieving the sort of standards in reporting, contract

design and trading that characterise non-Islamic products. These are gaining an increasingly strong international reputation and play an increasingly prominent role in international agencies. In addition, there are several international initiatives to develop, for example, Islamic swaps (using ISDA-style standard documentation) and Islamic Repo contracts (in collaboration with ICMA). It is to be expected that this process will continue, and will accelerate Islamic finance's acceptance into the mainstream of capital raising.

Many Islamic products, notably sukuk and takaful, have achieved general acceptance as valid contracts, both in non-Islamic countries and with Islamic scholars. There is now, therefore, a range of basic products (for example, equity, fixed income, mutual funds, insurance) which equate broadly with their non-Islamic counterparts. There is, however, a lack of risk management tools, in particular derivative contracts. These are widely seen as desirable, but to date their introduction has been impossible because of the difficulties of designing contracts that meet the requirements of Shariah law. Until this issue is resolved, it is hard to see that participants will be able to succeed over the longer term, unless adequate Islamic risk-management products are developed.

8.3.1 International effects

A number of recent events have accelerated the pace of change in GCC capital markets. Two of these are particularly noteworthy:

- The emergence of significant cross holding of UK and US exchanges by GCC partners (Dubai with NASDAQ, and Qatar with LSE). These holdings have been accompanied by co-operation agreements, under which the larger exchanges will share their technology, expertise and brands with their CGG counterparts. This may mean that issues which are currently seen as competitive between exchanges will in fact become collaborative.
- The UK government's position that the UK should become a major portal for Islamic finance. This has so far been accompanied by several initiatives, including changes in UK tax law to accommodate sukuk structures, and initiatives towards UK-government sukuk issue (although progress is slow). Whilst these may not, at present, have large monetary value, they are signals that the UK authorities see Islamic finance as an enduring part of the financial landscape.

8.4 Policy Issues and recommendations

This report was commissioned to analyse the scale, prospects for growth, and likely success of the various GCC countries. It also examines the impact of Islamic finance on the region and competitive aspects of the various financial markets in the region.

Our overall conclusion is that the enormous wealth of the region will have very large and ongoing effects, for example:

- The size of their Sovereign Wealth Funds makes the GCC countries significant, and very active, corporate investors worldwide. Their opaque structures and strategies may cause increasing frictions with regulatory

bodies outside the region, however, especially if they take stakes in major strategic companies.

- These funds, and other institutions, are adopting more aggressive external investment policies than has been traditional. One example of this is the acquisition of a large stake in the LSE by Qatar and the rather complex alliances between Dubai and NASDAQ. These developments cannot but secure the financial markets in these countries and render much of the previous analysis of "which markets can survive" redundant.
- It is widely acknowledged that policies to replace expatriate workers with nationals will be slow and may not be all-encompassing, simply because of the small size of the local population. What is clear, however, is that there is a need for properly supported and relevant training, at many levels including professional certification. Several initiatives are in train, both externally driven and also via procurement from the leading educational institutions in the region.

The development of GCC capital markets has been, and will continue to be, informed by best practice in Europe and North-America. In part this comes from the explicit adoption of various regulatory models, but it also comes from the use of foreign experts with their own professional exposure to those markets. This is leading to innovative market models in which local markets co-exist with internationally-focused ones, or in which both markets merge (to the expected betterment of both).

Islamic Finance as a re-emergent force in the region's corporate development is clearly a major factor. At one level this provides an opportunity for local firms to raise capital in ways that are less familiar in international markets; this provides a significant opportunity for the development and enhancement of locally derived expertise. On another level, this also provides new ways for financial engineers, from whatever background, to collaborate in the development of new financial products and financing structures, some of which may replicate the function of more conventional finance while others may offer innovative opportunities. The UK initiative to become the leading non-Islamic venue for Islamic finance is very important; it is to be hoped that the progress being made in legal and regulatory reform to permit the efficient issuance of sukuks and other Islamic instruments will become faster, as the value of the initiative becomes more apparent.

There are few recommendations for action at the end of this report, largely because the major initiatives, be they in market development, regulatory reform, corporate governance, training, or product innovation, are already in place and are proceeding apace, with the active participation of external agencies.

With the increasing integration of world markets, and the explicit alliances between international markets and those in the GCC, the appropriate questions are less concerned with which will survive or how they will compete with one another, and instead focus on how best they can evolve to co-exist in a broader international market structure.

Abbreviations used in the report

Organisations	
AAOFI	Accounting and Auditing Organisation for Islamic Financial Institutions
ADSM	Abu Dhabi Securities Market
BIBF	Bahrain Institute for Banking and Finance
BIS	Bank for International Settlements
Bpd	Barrels per day
BSE	Bahrain Stock Exchange
CBB	Central Bank of Bahrain
CBK	Central Bank of Kuwait
CDO	Collateralised Debt Obligation
CMA	Capital Markets Authority (Saudi Arabia)
CML	Capital Market Law
DCM	Debt capital market
DFM	Dubai Financial Market
DFSA	Dubai Financial Services Authority
DIFC	Dubai International Financial Centre
DIFX	Dubai International Financial Exchange
DME	Dubai Mercantile Exchange
DSM	Doha Securities Market
ENSC	Emirates National Securitisation Corporation
ESCA	Emirates Securities and Commodity Authority
ETF	Exchange Traded Fund
FDI	Foreign Direct Investment
GCC	Gulf Co-operation Council
GFCI	Global Financial Centres Index
GFCI	Global Financial Centres Index
IDB	Islamic Development Bank
IDB	Inter-dealer Broker
IEF	Index of Economic Freedom
IFI	Islamic financial institution

IFSB	Islamic Financial Standards Board
IFSL	International Financial Services London
IIF	Institute for International finance
IIFM	International Islamic Finance Market
IIFMI	International Islamic Financial Market Institute
IOSCO	International Organisation of Securities Commissions
KSE	Kuwait Stock Exchange
LSE	London Stock Exchange
MENA	Middle East and North Africa
MSCI	Morgan Stanley Capital International
OIC	Organisation of Islamic Conference
PSIA	Profit-sharing investment accounts
QFA	Qatar Financial Authority
QFC	Qatar Financial Centre
QFCA	Qatar Financial Centre Authority
QFCRA	Qatar Financial Centre Regulatory Authority
QFMA	Qatar Financial Markets Authority
SAMA	Saudi Arabian Monetary Authority
SPV	Special Purpose Vehicle
SWF	Sovereign Wealth Fund
UAE	United Arab Emirates
WB	World Bank
WFE	World Federation of Exchanges

Currencies

AED	UAE Dirham
BHD	Bahraini Dinar
KWD	Kuwaiti Dinar
QAR	Qatari Rial
SAR	Saudi Arabian Riyal

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The City of London Corporation

The City of London is exceptional in many ways, not least in that it has a dedicated local authority committed to enhancing its status on the world stage. The smooth running of the City's business relies on the web of high quality services that the City of London Corporation provides.

Older than Parliament itself, the City of London Corporation has centuries of proven success in protecting the City's interests, whether it be policing and cleaning its streets or in identifying international opportunities for economic growth. It is also able to promote the City in a unique and powerful way through the Lord Mayor of London, a respected ambassador for financial services who takes the City's credentials to a remarkably wide and influential audience.

Alongside its promotion of the business community, the City of London Corporation has a host of responsibilities which extend far beyond the City boundaries. It runs the internationally renowned Barbican Arts Centre; it is the port health authority for the whole of the Thames estuary; it manages a portfolio of property throughout the capital, and it owns and protects 10,000 acres of open space in and around it.

The City of London Corporation, however, never loses sight of its primary role – the sustained and expert promotion of the 'City', a byword for strength and stability, innovation and flexibility – and it seeks to perpetuate the City's position as a global business leader into the new century.