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Dubai Economic Council

Developing Dubai's debt market to promote investment and growth

Content

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Dubai Economic Council

His Highness Sheikh Mohammed Bin Rashid Al Maktoum, Vice President and Prime Minister of the UAE, and Ruler of Dubai

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The world's financial landscape has changed fundamentally over the last few years. Lessons drawn from the global financial crisis 2008 point to the pressing need to have an innovative financial architecture that is not only acting to provide adequate finance to governments and businesses, but also to be effective, timely and predictable in order to enhance the stability, wealth, social well-being, and environment sustainability, hence secure long-term growth for the local economy.

One of the significant developments happened in the global financial market, however is the rise of capital debt markets. International reports suggest that global debt capital deals have increased rapidly over the last few years and totaled US$5.7 trillion in 2014. Furthermore, in addition to the US and other western countries, Australia and Japan, new players have entered actively the said markets mostly from emerging markets.

If we look to Dubai, the last two decades have confirmed its position as a business capital of the UAE; thanks to its outstanding economic performance which has been the result of a deliberated policy aimed at integrating Dubai into the world economy and transforming it into an attractive regional and international hub for business and investment as underpinned by Dubai Plan 2021. However, in its quest to achieve this vision, the leadership of Dubai has placed the continued development of the financial sector, including the debt capital market, high on its policy agenda given the important role it plays in facilitating economic activity and promoting growth.

Precisely, in Dubai, further developing the local debt market both conventional and Islamic will have myriad advantages for the domestic economy, especially in a time where demand is picking up in the run up to EXPO 2020 and given the continued investment on infrastructure projects as well as the booming activities in the private sector. Also, we should start planning ahead for new and better ways of financing the growing future needs expected to arise from public and private sectors without putting too much pressure on the domestic banks.

Hence, this second edition of policy report prepared jointly by ‘Dubai Economic Council’ and ‘Deloitte’ has come at the right time, and succeeded in shedding the light on the most important issues related to the development of the debt capital market in Dubai.

Saying that, we look forward to various entities from both public and private sector in Dubai and UAE benefiting from this report in order to rationalize their decisions and maximize their gains when get involved in the local debt markets.

Sheikh Ahmed bin Saeed Al Maktoum

Foreword

We are delighted to announce the release of our second report in a series of publications aimed at encouraging investment in Dubai, titled "Developing Dubai's debt market to promote investment and growth," authored in collaboration between Deloitte Corporate Finance and the Dubai Economic Council.

The report is being released at a time where debt capital markets in particular can play a crucial role in enhancing the financial sector through their role in diversifying the sources of financing for both the government and the private sector, in addition to attracting more foreign direct investment.

A robust debt capital market offers an additional source of financing and can act as a source of stability to the economy by supporting growth across various economic cycles. The development of a deep and liquid debt market in Dubai is a continuous process, which will no doubt require collaborative support from both the private and public sectors to ensure efforts are harmonised and steered towards promoting investment and growth in Dubai.

This report clarifies the rationale for developing a local debt market and presents an analysis of the factors that are likely to provide the stimulus for the development and expansion of Dubai's conventional and Islamic debt markets. The report also provides a benchmarking of Dubai with other regional and international financial hubs that have either proven successful in attracting investment, or are at the stage of developing their debt capital markets and directly competing with Dubai. The benchmarking focuses on enhancing Dubai's profile and competitiveness in areas of product innovation, market infrastructure and regulatory frameworks, which are fundamental factors for driving the development of both conventional and Islamic debt markets.

Finally, the report identifies potential gaps that could impact Dubai's competitiveness and makes a number of policy recommendations that could support the development of the local debt market.

H.E. Hani Al Hamli
Secretary General
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Acknowledgement

The Dubai Economic Council (DEC) and Deloitte Corporate Finance Limited continue to share their vision and deploy their complementary comparative advantage to conceptualize, design and write the second edition of their annual reports on the financial sector in Dubai.

We would like to extend our gratitude to Her Excellency Sheikha Mona Abdullah Al Moalla, DEC Chief Operating Officer, Strategic Planning and Operations, for her role in creating the motivating work environment for the staff and enabling the timely completion of this report. Dr. Abdulrazak Al Faris, DEC's Deputy Secretary General for Economic Affairs, revised the report during its various stages and provided valuable comments. Special thanks go to the Deloitte technical team: Messrs. David Stark, Panos Stavropoulos and Karim Labban and DEC technical team: Dr. Ali Al Sadik, Dr. Mohamed Trabelsi, Ms. Dhuha Fadhel, Mr. German Gussakovskiy and

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We are grateful to Dubai Financial Market, Dubai Islamic Economy Development Centre, Dubai International Financial Center, HSBC bank and Emirates NBD bank for participating at a closed-door seminar aimed at engaging stakeholders and experts to have their insights and critical comments prior to the launch of the report, as well as the panel of experts; Dr. Magda Kandil, Dr. Sayd Farook, Mr. Mohammed Ali Yasin, Mr. Hussain Al Tajir and Mr. Chirag Shah who participated at the launch event of the report held on the 23rd November, 2015. Dr. Ibrahim Elbadawi, DEC's Director of Macroeconomics & Forecasting and Mr. Rajeev Patel, Director at Deloitte supervised all stages of the project and led the DEC-Deloitte joint team. Mr. Irfan Al Hassani, Mr. Mohamed Al Sayed, Ms. Dana Al Qatawneh and Ms. Nesrine Sabra helped in the media plan and invitation letters.

Last, but not least, we would also like to express our sincere gratitude to all 'other' DEC and Deloitte staff involved on this project in one way or another. We wish them all continued success and let us keep up the good work.

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Dubai Economic Council

Executive summary

I. Purpose of the report

The aim of this report is to identify factors that are likely to provide the stimulus for the development and expansion of Dubai's conventional and Islamic debt markets. In view of this, we consider other financial hubs, both regional and international, that have either proven successful in attracting investments, or are at the stage of developing their debt capital markets and directly competing with Dubai. Markets selected as a benchmark are as follows:

- Conventional debt markets: New York, London, Singapore, Hong Kong, Riyadh and Manama; and
- Islamic debt markets: Kuala Lumpur, London, Riyadh, Doha and Manama.

In light of this, our report is broadly structured as follows:

1. Executive summary outlining the policy recommendations emerging from the benchmarking analysis and focusing on:
   a. Supporting product innovation to increase market liquidity;
   b. Improving the underlying infrastructure to support issuance and trading;
   c. Enhancing the regulatory framework; and
   d. Developing the Islamic debt market, focusing on key areas of infrastructure, regulation and product innovation.
2. A brief overview of the rationale for having a local debt market;
3. Assessment of the financial sector and overview of recent developments in Dubai's debt market; and
4. Analysis of key benchmarking criteria, results and latest developments in peer markets.

II. Rationale for having a local debt market

A sound and well-functioning financial system can help sustain long-term economic growth as it allows for mobilising savings to more productive sectors in the economy and promoting financial stability. Additionally, a deep and liquid financial system with diverse instruments can offer resilience against shocks emanating from volatile markets.

Whilst the UAE has come a long way with the development of its financial system, the case for developing the local debt market is stronger due to a number of factors, including:

- The robust fundamentals and economic growth of the UAE are supporting increased demand from international investors for high-quality papers issued by the Government and large corporates;
- The continued investment in infrastructure and other developmental projects increase the need for diverse sources of funding with long-term maturities;
- The development of the local debt market will help diversify the existing funding of Government Related Entities (GREs) and large corporates, which are currently heavily dependent on bank financing. This can also reduce the systemic risk within the economy and provide banks with further flexibility in terms of complying with central bank regulations that limit the exposure of banks to no more than 100% of their capital base;

A deep and liquid local bond market is fundamental for the development of Dubai's financial sector. This could further promote financial stability and support economic growth in Dubai and the UAE.

- A local debt market can facilitate the sterilisation of large capital inflows, and improve the implementation of the country's monetary policies. It can also help mitigate exchange rate risks by providing an alternative source of multi-currency financing without having to resort to foreign sources of capital; and
- The latest efforts and initiatives to establish Dubai as a global Islamic financial centre will increase demand from investors for high quality Islamic papers, which can be partially met by issuing local currency Sukuk.
- A deep and liquid local debt market will provide the monetary authority with better tools to address the divergent business cycles between the economies of the UAE and the US, to which the UAE Dirham is being pegged, especially in a time of low oil prices that causes market liquidity to dry up.

III. Financial sector assessment

Overview of the Financial Development Index's result

The Financial Development (FD) index published by the International Monetary Fund (IMF) was used in this report as an indicator to assess the development of the financial sector in the UAE compared to other benchmarks. The ranking in the index is largely derived from two sub-indices, namely:

- The Financial Institutions (FI) index; and
- The Financial Market (FM) index.

The chart below sets out the ranking of the UAE under each of the three indices, compared to the ranking of the other benchmarking countries. A higher score would indicate a more developed financial sector.

The UAE appears to be lagging behind global financial centres, such as Malaysia, UK, Singapore, USA, and Hong Kong but is well positioned compared to some of the other regional financial centres, such as Bahrain and Qatar.

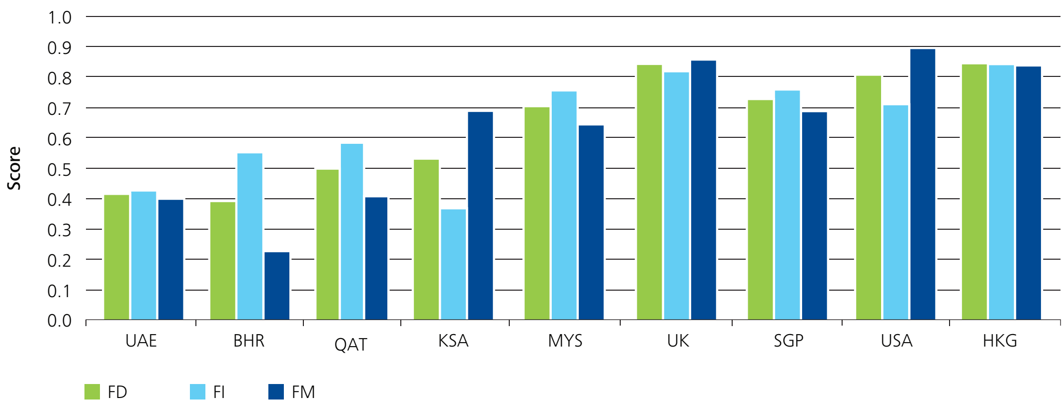
The ranking of regional financial centres on the same index has remarkably improved compared to the UAE over recent years. This highlights the need to cope with the growth of these financial centres by further developing the UAE's financial sector and local debt market.

Overview of historical debt issuance

The UAE remains the largest bond market in the GCC in terms of issuance with around USD 19 billion of new bond issuances in 2013, representing a 41% market share of total new issuances in the GCC.

In addition, Dubai accounted for about 72% of the total bond issuances in the UAE in 2014 and has become the world leader in the Islamic bond industry overcoming other Islamic debt markets with a USD 36.7 billion nominal value of listed Sukuk in 2014.

Nevertheless, the UAE lags behind other GCC countries in terms of total debt issuances (rather than bond issuance only) given that the central bank of UAE does not currently issue other type of debt products, such as treasury bills, notes and Sukuk denominated in local currencies.



Source: The Financial Development Index published by the International Monetary Fund, 2015

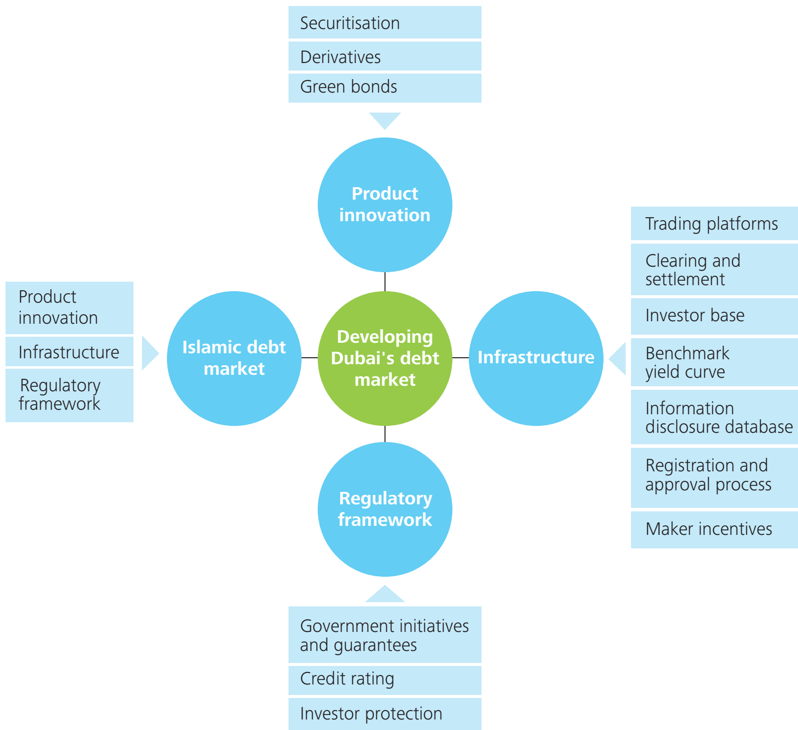
IV. Reaching the next level

To enable Dubai to further develop its conventional and Islamic debt markets a benchmarking analysis was conducted to identify challenges and improvement opportunities. Whilst Dubai currently surpasses its regional neighbours Riyadh and Manama with regards to conventional debt market maturity, further opportunities for development exist to enable it to compete with leading financial hubs, such as New York, London, Signapore and Hong Kong. The underlying development areas include strengthening the protection of investors' rights, developing the underlying trading infrastructure and framework to accommodate derivatives, targeting retail investors and establishing an effective benchmark yield curve.

With regards to the maturity of its Islamic debt market Dubai ranks similarly with its regional neighbours, Riyadh and Doha, whilst Kuala Lumpur represents the leading market, followed by Bahrain and London. Dubai could further develop key areas, such as dispute resolution and bankruptcy regulation for Sharia'a compliant products, development of a Sharia'a compliant repurchase agreement and introduce a platform to allow retail investors to access the primary Sukuk market.

In order to assess Dubai's competitive position within debt markets, we have conceptualised the following framework, which was used as part of the benchmarking analysis covering the following areas of product innovation, supporting infrastructure and the effectiveness of the regulatory framework, which we considered as the fundamental factors in the development of the conventional and Islamic debt markets.

Enhancing Dubai's profile and competitiveness in areas of product innovation, market infrastructure and regulatory frameworks is fundamental for the development of both conventional and Islamic debt markets



The tables below summarise how Dubai ranks against the benchmark markets under the three main areas of product innovation, infrastructure and regulatory framework.

Dubai's conventional debt market is more mature compared to its regional neighbours, Riyadh and Manama in the areas of product innovation and infrastructure. Compared to more developed cities, such as New York, London, Singapore and Hong Kong, Dubai is less developed with regards to the use of derivatives and green bonds, an effective benchmark yield curve is under-developed, and the registration and approval process for bond issuances is relatively longer.

Additionally, the current regulatory framework provides less protection to investors, primarily due to limitations in the current bankruptcy and dispute resolution regulations.

In the areas of clearing and settlement infrastructure, Dubai ranks on par with New York, London, Singapore and Hong Kong, whilst with regards to the use of covered bonds and the supporting regulatory framework, it ranks higher than New York and Singapore. Dubai also ranks on par with Hong Kong in the areas of maturity of trading platforms, but slightly behind New York, London and Singapore mainly due to the lack of a derivatives trading platform.

Conventional debt market benchmarking

Category	Dubai	New York	London	Singapore	Hong Kong	Riyadh	Manama
Product innovation							
Covered bonds	Well developed	Under-developed	Well developed	Under-developed	Not available*	Not available*	Not available*
Derivatives	Under-developed	Well developed	Well developed	Adequate	Adequate	Under-developed	Under-developed
Government bond derivatives	Not available*	Well developed	Well developed	Well developed	Well developed	Not available*	Not available*
Green bonds	Not available*	Adequate	Adequate	Under-developed	Under-developed	Not available*	Not available*
Infrastructure							
Trading platforms	Adequate	Well developed	Well developed	Well developed	Adequate	Adequate	Adequate
Clearing and settlement	Well developed	Well developed	Well developed	Well developed	Well developed	Adequate	Adequate
Investor base	Adequate	Well developed	Well developed	Adequate	Adequate	Under-developed	Adequate
Benchmark yield curve	Under-developed	Well developed	Well developed	Adequate	Adequate	Under-developed	Under-developed
Database for information disclosure	Adequate	Well developed	Well developed	Adequate	Well developed	Under-developed	Under-developed
Registration and approval process	Adequate	Well developed	Well developed	Well developed	Well developed	Adequate	Adequate
Regulatory framework							
Credit rating	Adequate	Well developed	Well developed	Well developed	Well developed	Under-developed	Adequate
Investor protection	Under-developed	Well developed	Well developed	Well developed	Adequate	Under-developed	Under-developed

*product not used

Source: The ratings applied for each of the benchmark markets are illustrative and directional based on qualitative research and not purely based on quantitative indicators

In terms of maturity of the Islamic debt market Malaysia is the most developed, whilst Dubai ranks on par with Riyadh and Doha with regards to product innovation, supporting infrastructure and the regulatory framework. Dubai has recently announced a number of initiatives, such as the development of a Sharia'a compliant repurchase agreement, a platform to allow retail investors access to the primary Sukuk market and the UAE announced plans for the establishment of a Sharia'a board to oversee standards, which if implemented could allow Dubai to overtake Riyadh, Doha, London and Manama and also bring the city on par with Kuala Lumpur. In addition, London and Kuala Lumpur have a more developed dispute resolution and bankruptcy regulatory framework when compared to Dubai.

Islamic debt market benchmarking

Category	Dubai	Kuala Lumpur	Riyadh	Doha	London	Manama
Product innovation						
Sharia'a compliant repurchase agreement	Not available (announced)	Under-developed	Not available	Not available	Not available	Under-developed
Sharia'a compliant derivatives	Under-developed	Under-developed	Under-developed	Under-developed	Under-developed	Under-developed
Green Sukuk	Not available (UAE announced plan)	Well developed	Not available	Not available	Not available	Not available
Infrastructure						
Secondary Sukuk trading platforms	Adequate	Well developed	Adequate	Adequate	Adequate	Adequate
Primary offering to retail investors	Not available (under development)	Adequate	Not available	Not available	Not available	Under-developed
Regulatory framework						
Dispute resolution and bankruptcy regulation	Under-developed	Adequate	Under-developed	Under-developed	Well developed	Under-developed
Sharia'a board to oversee standards	Not available (announced plans at federal level)	Well developed	Not available	Not available	Not available	Not available (announced plans)
Primary sales of Sukuk to retail investors	Not available (announced by Nasdaq Dubai)	Well developed	Not available	Not available	Not available	Adequate

Source: The ratings applied for each of the benchmark markets are illustrative and directional based on qualitative research and not purely based on quantitative indicators.

The above conceptual framework and summary of the benchmarking results are underpinned by detailed analysis in the benchmarking analysis section of this report. The remainder of this executive summary presents the key policy recommendations derived from the benchmarking results.

Following a qualitative benchmarking analysis against peer international and regional financial hubs, a number of areas for improvement have been identified across both conventional and Islamic debt markets

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V. Key policy recommendations

We have identified a number of key policy recommendations, which span the four key areas of our benchmarking analysis:

a. Product innovation to meet market requirements and increase liquidity;
b. Infrastructure enhancements to support primary market issuance and secondary trading for institutional and retail investors;
c. Formalisation of the regulatory framework to support the market; and
d. Development of the Islamic debt market focusing on key areas of product innovation, infrastructure and regulation.

The introduction of new debt products on Dubai's exchanges, including derivatives and green bonds can promote liquidity and bolster demand in the debt market

The policy recommendations below focus on improvement opportunities for Dubai to enable further development and growth of its debt market.

Product innovation to increase liquidity

Product innovation can play an important role in developing markets, and recommendations could include the following:

- The introduction of derivatives on Dubai's exchanges (e.g. interest rate swaps, Government bond forwards and currency exchange swaps) may help support risk management and increase market liquidity. The timing of introducing these products should be assessed to ensure that the debt market has reached the appropriate size and adequate investor appetite is present. In addition, the appropriate regulatory framework should be developed to regulate issuance and trading of these products, supported further through the development of an electronic trading platform.
- The introduction of appropriate regulation for the issuance and trading of green bonds, with a view to enable trading on its exchanges once debt market size and demand reach satisfactory levels.

Infrastructure enhancements to support issuance and trading

There are a number of key infrastructure enhancements that could be considered to support issuance and trading:

Trading platforms

- In order to accommodate additional products, such as derivatives, further development of the existing electronic trading platforms may be required.
- Dubai Financial Market (DFM) may seek to increase market liquidity by accommodating Exchange Traded Funds (ETFs) and Real Estate Investment Trusts (REITs).
- NASDAQ Dubai may establish a platform to target retail investors, allowing for the primary issuance and on-screen secondary trading of Government bonds, in line with the exchange's recent announcement. The DFM may shadow this approach and adopt a similar platform to target retail investors, once justifiable maturity levels are reached.
- In attracting additional investors, Dubai may consider further developing the connectivity of the trading platforms on its exchanges to include direct connections with other platforms in the UAE, along with other regional markets.
- Furthermore, the trading hours of Dubai's exchanges could be extended, in line with international markets, to bolster trading activity during shoulder periods of the day and increase foreign investor participation. Market maturity and liquidity levels should be assessed in parallel with the additional costs associated with extending trading hours.

Clearing and settlement

- To be in line with the more developed markets of London and New York, Dubai may wish to consider shortening the settlement cycle for Government bonds thereby providing the stimulus for increased activity levels through faster execution and reduced settlement risk.

Investor base

- To further boost liquidity, the debt market's investor base may be widened by targeting a broader spectrum of investors, including foreign institutions, Islamic institutions and retail investors. The development of additional products and offerings, such as green bonds, derivative products and Sharia'a compliant products, may be a further catalyst to attracting additional investors to the debt market.

Benchmark yield curve

- Dubai may consider issuing a wider range of Government bond maturities in an effort to establish a more effective benchmark yield curve, further supporting market participants in pricing corporate issues more effectively across a wider range of maturities.
- The frequency of Government bond issues may also be increased. In addition, quasi-Government corporations may be incentivised in order to galvanise them to issue bonds and maintain an up to date benchmark yield curve.
- Dubai may also consider introducing an issuance calendar for Government bonds including Sukuk, thereby providing investors with visibility over planned issues, which could lead to improved market transparency and investment levels.

Information disclosure database

- Dubai may seek to introduce a database to capture information with regards to issuers and trades, in particular relating to Over the Counter (OTC) trades where access to information is limited as compared to other trades executed. This may lead to increased market transparency and better pricing of issues, culminating in stronger investor participation.
- To ensure the proper and effective safeguard of data, platforms that facilitate and promote the electronic submission of information and disclosures by issuers may be introduced.

Registration and approval process

- In line with other markets, such as London, Signapore and Hong Kong, NASDAQ Dubai may consider reducing the admission time for issuers. In addition, Dubai's exchanges could consider adopting tailored registration and approval processes to cater for different types of investors and issuances.
- In 2014, the UAE's Securities and Commodities Authority (SCA) introduced the debt securities issuance programme to allow for a fast track process for regular issuers, in an effort to reduce the approval cycle. The approval and admission process could further be tailored based on the issuance rating (e.g. high vs. low quality), the type of investors (institutional vs. retail) and the type of corporate bonds issued (plain vanilla vs. complex structures).

Developing the debt market's infrastructure is key to support efficient trading and encourage issuers and investors' participation

Market making incentives

- DFM could further increase market liquidity by providing incentives to market makers, to attract them on its exchange. In 2012, the SCA approved market making regulations in an effort to increase market liquidity, however the DFM exchange currently has no market makers appointed. In comparison Nasdaq Dubai has successfully incentivised market makers to join the exchange by offering a 100% rebate on trading and clearing fees to encourage participation and improve liquidity. DFM could potentially offer fee rebates to market makers as well as consider adding flexibility to current market making requirements, which set limits on the number of transactions and number of trading days in a security.

Formalise the regulatory framework

A number of improvement opportunities have been identified to enhance the regulatory framework and further support the development of Dubai's conventional debt market:

Credit rating

- In 2014, the SCA announced that it is no longer mandatory to obtain credit ratings from rating agencies. Cancelling the requirement for mandatory ratings should be considered in the context of encouraging issuers and making it more cost and time effective to offer bonds, against discouraging investors who seek to assess the credit risk of issuers by reverting to credit rating agencies.
- Whilst mandatory credit ratings might have lost some of its popularity in the aftermath of the global financial crisis, the availability of credit ratings remains critical to add transparency to the bond market and encourage investor participation by providing a vehicle for credit risk assessment of issuers. This is rendered even more important in a market dominated by privately held corporates where investors have limited access to the corporates' financial information.
- Consequently, it is recommended that Dubai's regulators and exchanges incentivise, or at the very least, encourage issuers to obtain credit ratings, even if this is not made mandatory. This can ensure sufficient transparency of information, in a market dominated by family offices and privately held businesses that have no obligations to publish their statutory accounts.

Investor protection

- Appropriate reforms to existing bankruptcy laws in Dubai could be made to ensure adequate investor protection. In addition, there is a compelling case for more emphasis to be placed on restructuring mechanisms to provide for the fair and efficient reorganisation of potentially distressed issuers, allowing for the issuer to plan for restructuring and resolution in advance. As a result, investors would be able to rationally assess the risk of investing in bonds, and the likelihood of a resolution, whether in part or in full, in the event of default.
- Further, Dubai may improve the efficiency of settling disputes by aligning arbitration regulation to international standards.

Other financial regulations and Government initiatives

- Dubai markets may benefit from aligning agendas and efforts of various national regulatory authorities, paving the way for a coherent plan to drive development of the bond market. The achievability of this will be predicated on having a specific panel comprising of government officials, regulatory authorities (including central bank representatives) and industry experts, addressing the various challenges and impediments to the development of a bond market, aligning respective priorities and agendas to achieve a harmonised plan.
- Dubai may also consider providing further protection against lower-rated corporate issues to promote these products in the debt market, orchestrated by setting up specialised third-party guarantee institutions that render such services.
- The introduction of a state pension schemes for both the private and public sector could support an increase in the establishment of pension funds. Pension funds could subsequently act as a vehicle for deepening the debt market, as they are key investors in debt products.

A well structured and bespoke regulatory framework is recommended to promote market transparency and increase investors' confidence

Develop the Islamic debt market

Developing further the Islamic debt market could play a considerable role in attracting further investment and establishing Dubai as the leading global Islamic financial centre. A number of policy recommendations have been identified to support this:

Product innovation

- New regulations and standards in respect of Sharia'a compliant derivatives (such as currency and profit rate swaps) may be introduced in order to support investors in hedging their positions. Such derivatives could ultimately be traded on NASDAQ Dubai and the DFM to ensure further transparency, but the introduction of these instruments on the exchanges would need to be timed appropriately to ensure that the market size and demand is adequate. In addition, the appropriate supporting infrastructure should be present to allow trading of such instruments.
- Introduction of a Sharia'a compliant repurchase agreement, in line with NASDAQ Dubai's announcement, could support an active secondary market of Sukuk trading, which could also be adopted by the DFM exchange in the future.
- Dubai could further develop the appropriate regulatory framework for green and socially responsible investment Sukuk. Becoming the first city to issue a corporate green Sukuk may provide Dubai with a distinct competitive advantage.

Infrastructure

- Trading activity and liquidity levels on NASDAQ Dubai's Murabaha trading platform could be enhanced further through the introduction of a Murabaha index, or via publishing information on Murabaha trades in an attempt to provide market participants with greater transparency. The existing Murabaha platform could be expanded to incorporate other Islamic products, such as Ijara.
- To boost liquidity, Dubai could continue the issuance of Government Sukuk at various maturities and on a more frequent basis, as well as encourage state owned and other corporations to issue Sukuk locally rather than abroad.
- Implementation of the underlying platform to enable primary sales of Sukuk to retail investors, in line with NASDAQ Dubai's announcement, with a similar platform potentially to be implemented in the DFM in the future, could be considered.

Further developing Dubai's Islamic debt market could play a considerable role in attracting investment and establishing Dubai as the leading global Islamic financial centre

Regulatory framework

- Further developing the dispute resolution regulatory framework for Islamic transactions, could support market growth and further improve Dubai's position in becoming the leading Islamic financial hub. DFSA's arbitration knowledge and practices could potentially be utilised to support the drafting of such regulation.
- Collaboration with other leading Islamic hubs, such as Kuala Lumpur, London and GCC hubs could aid the standardisation of practices and further support foreign investment. In addition, continued motivation by the Dubai authorities to support local entities to issue Sukuk in Dubai, rather than abroad, could further support market liquidity.
- The establishment of a central supervisory Sharia'a board to oversee and ensure transactions and products conform to Islamic standards, could reduce future disputes and increase transactions.
- Dubai may potentially implement a similar framework to Kuala Lumpur, to allow for Sharia'a Scholars that hold executive management positions to advise only one institution at any given time in a particular market segment, to avoid any potential conflicts of interest.
- NASDAQ Dubai may design and implement a framework to target retail investors, in line with recent announcements, allowing for access to primary Sukuk issues and secondary online trading to increase liquidity. A similar framework with appropriate changes could potentially be adopted by the DFM.

Rationale for having a local debt market

A vast body of economic literature supports the premise that to sustain long-term economic growth, it is imperative to have a sound and well-functioning financial system. Such a system can yield several benefits to the economy as it helps mobilise savings to more productive sectors, improves resource allocation, facilitates diversification and promotes better mechanisms of risk sharing. It can also promote financial stability as deep and liquid financial systems with diverse instruments, backed by a strong regulatory framework, can provide buffers against shocks emanating from volatile markets.

The UAE has come a long way with the development of its financial system by the establishment of several domestic and foreign banks* and by the establishment of its two stock exchanges in Abu Dhabi and Dubai, in addition to the offshore financial center DIFC. The UAE also continues to improve and modernise its set of rules and regulations in the banking sector with the aim of achieving a resilient financial system that continues to foster economic development.

Whilst the UAE has come a long way with the development of its financial system, a number of additional development areas that can be addressed in order to cope with the growth of other peer financial centers

Nevertheless, a high-level benchmarking analysis comparing the financial development of the UAE to that of other regional and international financial hubs indicates a number of development areas that the UAE can address, in order to cope with the growth of other peer financial centres. A detailed assessment of the UAE's financial sector is presented in the "financial sector assessment and overview of the debt market" section of this report.

One potential area of development that has been discussed extensively after the Asian crisis of the late nineties and was reinvigorated after the 2008 global financial crisis, especially in the context of emerging markets, is the development of local debt markets. Specifically, the development of a deep local debt market can help achieve the following objectives:

- Provide tools for the Government to finance large fiscal deficits without having to resort to borrowing from domestic banks or tapping into foreign sources of capital which might expose the country to exchange rate risk or risks of "sudden stops" in capital inflows;
- Facilitate the sterilisation of large capital inflows, and improve the implementation of the country's monetary policies;
- Provide an alternative to bank lending and offering relatively cheaper financing to large reputable firms. This can have a direct implication on lending to small and medium-sized enterprises as more bank resources

*According to the most recent statistics of the central bank of UAE, 51 local and foreign banks with 1,184 branches are currently operating in the UAE.

can be utilised for other loan recipients other than Government related entities and large firms;
- Promote market discipline and transparency through improving the quality and disclosure of information; and
- Enhance financial stability by having a more diverse financial system compromised of capital markets alongside banks. This system can better absorb shocks created by banking crises by providing a substitute to bank finance.

In the context of Dubai and the UAE at large, the case for a local debt market is strong due to a number of factors. These include:

- The robust fundamentals and economic growth of the UAE are increasing demand from international investors for high-quality papers issued by the Government and large corporates;
- The continued investment in infrastructure and other developmental projects increases the need for new sources of funding with long-term maturities. This can be partially addressed through the issuance of long-term debt instruments;
- The development of the local debt market will help diversify the existing funding of GREs and large corporates in the UAE, which are currently heavily dependent on bank financing. This in turn can reduce the systemic risk within the economy and provide banks with further flexibility in terms of complying with central bank regulations that limit the exposure of banks to no more than 100% of their capital base;
- A local debt market will help mitigate exchange rate risks by providing alternative sources of multi-currency financing without having to resort to foreign sources of capital. It can also reduce the risk of "sudden stops" or reversals in international capital flows; and

In the context of Dubai and the UAE at large, the case for developing the local debt market to promote investment and growth is strong

- The latest efforts directed towards turning Dubai into a global capital of an Islamic economy will create more demand from investors for high quality papers, which can be partially met by issuing local currency Sukuk.
- Moreover, the divergent business cycles of the economies of the UAE and the US, to which the UAE Dirham is being pegged, could render the UAE monetary policy more complicated in certain times. For example, the recent hike of the US interest rate which was followed instantaneously by a similar rise in the UAE policy rate might have come in a time when the UAE economy is in need for a further expansionary rather than a contractionary monetary policy to help boost market liquidity which was markedly affected by the falling oil prices since mid-2014. Hence, the development of a deep and liquid local debt market can help support market liquidity in the UAE despite the diverging business cycles of the two economies, and in fact, it can also provide an effective tool for enhancing the transmission mechanism of monetary policy.

Financial sector assessment and overview of the debt market

Overview of the financial development index
The Financial Development (FD) index published by International Monetary Fund (IMF) was used in this report as an indicator to assess the development of the financial sector in the UAE compared to other benchmarks.

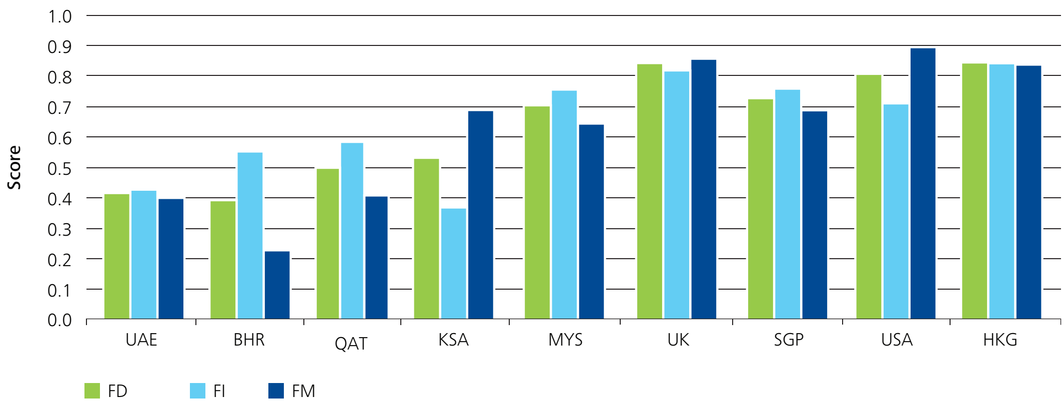
Based on the IMF's FD index of 2013, the UAE appears to be lagging behind international financial centres, such as Malaysia, UK, Singapore, USA, and Hong Kong but is well positioned compared to some of the other regional financial centres, such as Bahrain.

The UAE appears to be lagging behind international financial centres, but is well positioned compared to some of the other regional financial centres, such as Bahrain

The ranking of the regional financial centres on the same index has remarkably improved compared to the UAE over the recent years. This highlights the need to cope with the growth of these financial centres by further developing the UAE's financial sector and local debt market.

The decomposition of the FD index into its sub-components of the Financial Institutions (FI) and Financial Market (FM) indices provides further insights into these numbers. For instance, the UAE ranks ahead of Saudi Arabia on the FI index but lags behind the rest of the countries on the same measure. On the other hand, the UAE ranks ahead of Bahrain but on par with Qatar on the FM index. However, the substantial gap between the UAE and Saudi Arabia, as well as between the UAE and the other global financial centers, suggests that further scope for improvement exists for the UAE.

The financial development indicators in the UAE and selective regional and global economies in 2013



Source: The Financial Development Index published by the International Monetary Fund, 2015

The new Financial Development (FD) index of the IMF

The IMF's new FD index provides a broader measure of the state of financial development in each of the 176 countries included in the sample covering the period 1980-2013. The index provides a far more comprehensive measure of financial development including but not limited to; the percentage of population with bank accounts or private sector credit as a percentage of GDP. The index offers a composite score capturing both financial institutions (FI), such as banks, insurance companies, mutual funds and pension funds, and financial markets (FM), including stock and bond markets.

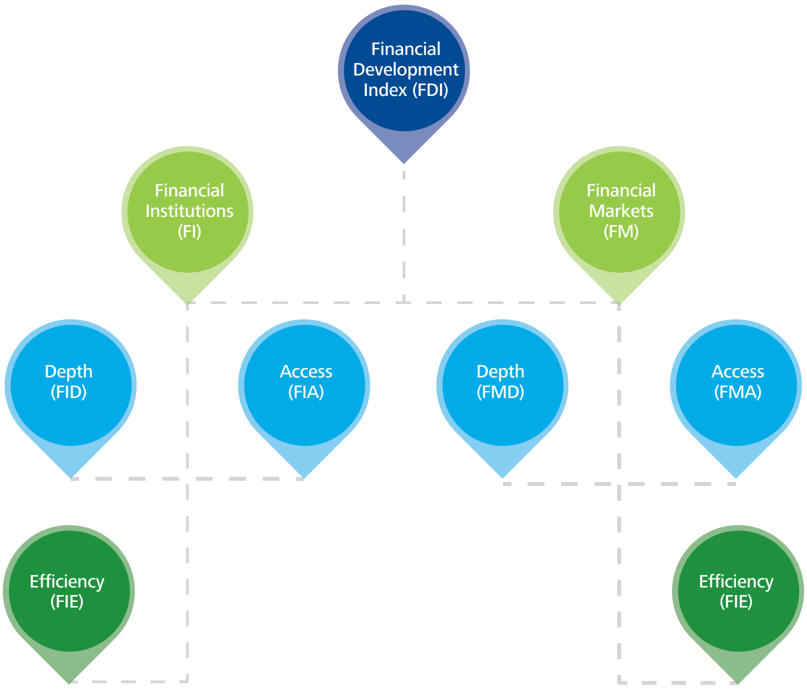
Moreover, the new FD index covers:

- Depth - size and liquidity of markets;
- Access - ability of individuals to access financial services; and
- Efficiency - ability of institutions to provide financial services at low cost and with sustainable revenues and level of activities in capital markets.

In light of this, the IMF's FD index offers the best approximate for the status of financial development, which allows for the benchmarking of the UAE's financial development in comparison to other peer regional and international hubs.

The chart below shows the decomposition of the FD index into its two main sub-components, FI and FM indices, constructed using weighted averages of key indicators of depth, access and efficiency within each index.

The IMF's Financial Development Index



Source: "Rethinking Financial Deepening: Stability and Growth in Emerging Markets," IMF Staff Discussion Note, May 2015.

The UAE's financial sector assessment was based on the IMF's financial development index. This takes into account the depth, access, and efficiency of both financial institutions and financial markets development.

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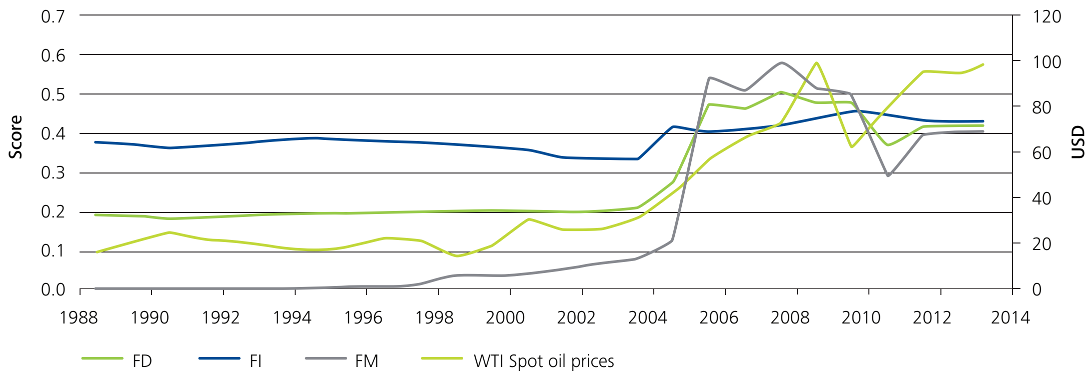
The Evolution of the Financial Development indices
The UAE has maintained a stable pace in developing its financial sector throughout the eighties and nineties. However, the development of the financial markets in the UAE started to pick up in the late nineties, largely driven by the rise of oil prices and global reforms that followed the Asian crisis of the late nineties.

The development of financial markets in the UAE appears to have a strong correlation with the oil cycle as depicted in the graph below. This is evident through the period from 2004 onwards, which witnessed a series of boom and bust in oil prices. In parallel with rising oil prices, the Government followed an expansionary fiscal policy that helped in boosting economic activity and pumping more liquidity into the market.

The evolution of the financial development in the UAE and global oil prices over the period 1988-2013

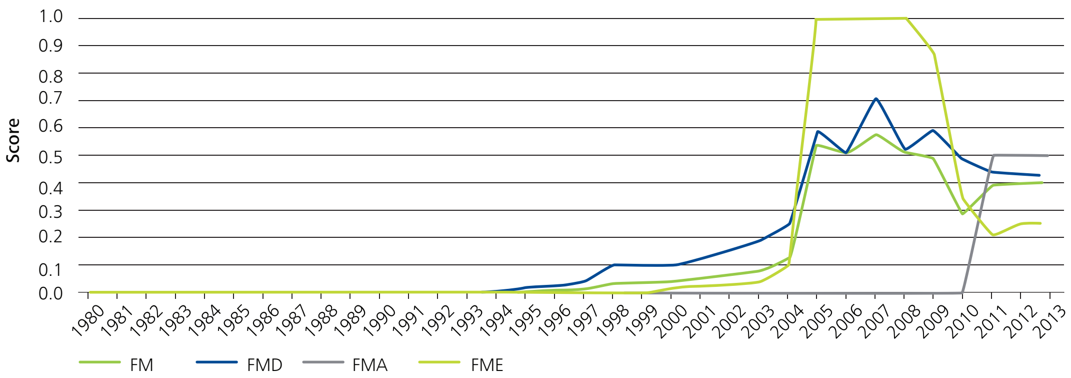


Source: The Financial Development Index published by the International Monetary Fund, 2015

The development of financial markets in the UAE appears to have a strong correlation with changes in oil prices

Aided by an environment of low interest rates and with the inauguration of the DIFC as the first offshore financial center in the region, the FD Index (and more specifically the FM index) increased substantially through the second half of the 2000s. However, the global financial crisis of 2008 and the subsequent drop in oil prices led to a sharp decrease in the FD and the FM indices before these two indices stabilised at an average score of 0.4 between 2011 and 2013.

The UAE's FM index components



Source: The Financial Development Index published by the International Monetary Fund, 2015

Financial Market index in the UAE

The above graph shows a breakdown of the UAE's FM index based on depth (FMD), access (FMA) and efficiency (FME). In addition, it shows the evolution of each index component over the period from 1980 to 2013.

The UAE's FM depth and efficiency indices have been moving very closely with the oil cycle.[1] In particular, the significant improvement in FM efficiency through the period from 2004 to 2008 provided a remarkable boost to the UAE's financial markets, as evidenced by the improving, albeit swinging, FM depth index during the same period.

However, the two sub-indices have plummeted in the recent years in the aftermath of the global financial crisis, tightening liquidity, rising credit spreads and falling oil prices. On the other hand, the FM access index has been historically very low till 2010 when the number of debt issuers increased substantially pushing the FM access index to a high level of 0.5 on a zero to one scaled index. Despite this remarkable improvement, accessing UAE's FM remained stagnant throughout the following years.

[1] FM depth index is constructed using measures such as: stock market capitalization to GDP; stock traded to GDP; international debt securities Government (% of GDP); total debt securities of nonfinancial corporations (% of GDP); and total debt securities of financial corporations (% of GDP). FM efficiency is a proxy by the stock market turnover ratio (stocks traded/capitalization). FM access is measured by the percent of market capitalization outside of the top 10 largest companies and the total number of issuers of debt (domestic and external, non-financial corporations and financial corporations).

The financial market development in the UAE has slowed down in the aftermath of the global financial crisis. This was the result of tightening liquidity, rising credit spreads and a significant decrease in oil prices.

Financial Institutions index in the UAE

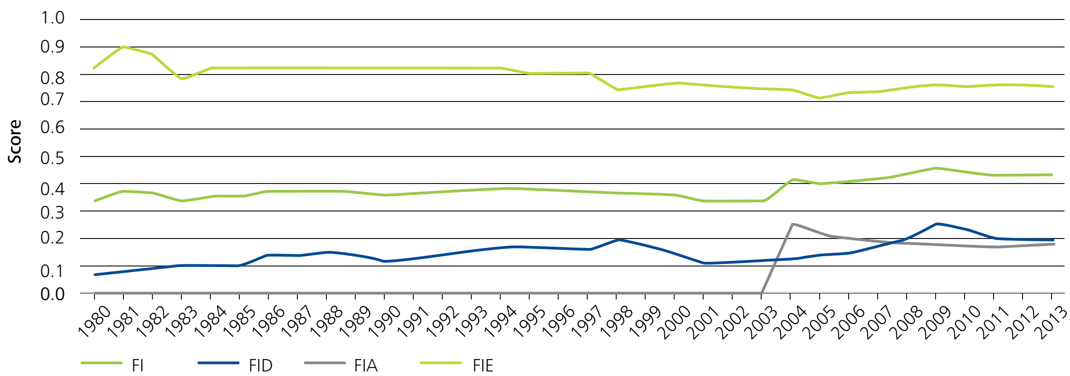
The below graph presents a breakdown of the FI index based on the depth (FMD), access (FMA) and efficiency (FME) and shows the evolution of each component over the period from 1980 to 2013 in the UAE.

Despite the improving depth and access measures of the UAE's financial institutions throughout the latest decade, they remain far below the efficiency levels achieved by these institutions

There appears to be a slight progress in the development of the UAE's financial institutions as the FI index increased slightly from an average score of 0.35 in the period from 1980 to 2003 to an average score of just over 0.4 registered in 2013. However, a stable decrease in the FI efficiency index from 1981 to 2013 highlights the need to carefully consider and address this issue.

On the other hand, despite the improving depth and access measures of the UAE's financial institutions throughout the latest decade, they remain far below the efficiency levels achieved by these institutions. In order for these indicators to improve, additional efforts should be made to increase the share of non-bank financial institutions' assets in the financial sector, and improve the access to these institutions through the establishment of more branches.

The UAE's FI index components



Source: The Financial Development Index published by the International Monetary Fund, 2015

Other financial development indicators

Similar to other economies in the region, the UAE's financial system is characterised by a large banking sector, which in turn finances a significant share of the private sector's funding needs (i.e. approximately 60% of private credit is being funded by banks). In addition, the exposure of the UAE banking sector to Government and other state-owned entities is one of the highest in the region, at nearly 20% of its GDP. It significantly exceeds the ratios observed in Saudi Arabia (8%) but is lower than the ratio registered in Qatar (24%). In an international context, the exposure of the UAE's banking sector to Government entities is found to be four times the exposure in the UK or the US. However, it is lower than that in Hong Kong (38%) and Singapore (27%).

Moreover, despite the fact that the UAE's stock market is the second largest market in the GCC in absolute terms, it is low relative to the country's GDP (i.e.18.4% of GDP in 2012) when compared to other GCC economies or other major international centers, such as Hong Kong, Singapore, the US or the UK.

In terms of debt security issuances, the UAE comes second within the GCC in the value of its international debt issuances relative to its GDP (28%), just behind Bahrain (33%) and ahead of Qatar (23%). The UAE also outperforms advanced economies, such as Singapore (25%) and the US (19%) in its international debt issuances. In fact, the latter economies have a well-developed domestic debt securities markets where they issue most of their debt instruments and attract external issuers to issue securities in their markets.

The table below shows a selection of financial development indicators in the UAE and other economies in 2012:

Country	Corporate bond issuance to GDP (%)	Credit to Government and State enterprises to GDP (%)	International debt issues[1] to GDP (%)	Private credit by FIs b to GDP (%)	Stock market capitalisation to GDP (%)
UAE	1.6	20.2	28.1	60.3	18.4
Bahrain	-	20.7	32.7	97.6	54.4
Qatar	1.1	23.7	22.8	35.7	66.2
Saudi Arabia	0.3	7.9	-	46.5	48.4
Malaysia	5.8	11.9	15	111.3	142.1
Hong Kong	7.6	38.1	37.6	194.4	378.4
Singapore	5.3	27.4	24.7	112.5	126.3
USA	4.8	5.1	18.6	176.6	107
UK	4.9	5.3	107	168.2	112.1
World	2.4	6.8	12.9	38.8	30.8

Source: The Global Financial Development Database, the World Bank.
Note 1: International debt issues cover long-term bonds and notes and money market instruments placed on international markets.
Note 2: Private credit to FIs includes private credit to banks.

The exposure of the UAE banking sector to the Government and other state-owned entities is one of the highest in the region, at nearly 20% of its GDP

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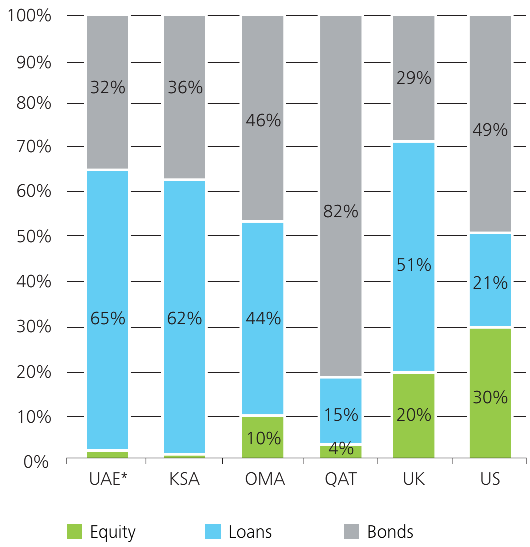
Private external financing

The structure of private external financing (as illustrated in the chart) suggests that the private sector in the UAE is still heavily reliant on bank loans to finance their capital structure, especially when compared to other economies within the region and across the globe.

However, there was a temporary exception to this trend in 2011 and 2012 due to a surge in bond issuances by several corporates, driven by the tightening of bank lending in the domestic market, and by investors aiming to benefit from a globally low interest rate environment. As banks resumed lending in 2013, encouraged by a favorable economic setting, private firms increased their borrowing from banks, which increased to 65% of their total external financing.

The private sector in the UAE is heavily reliant on bank financing

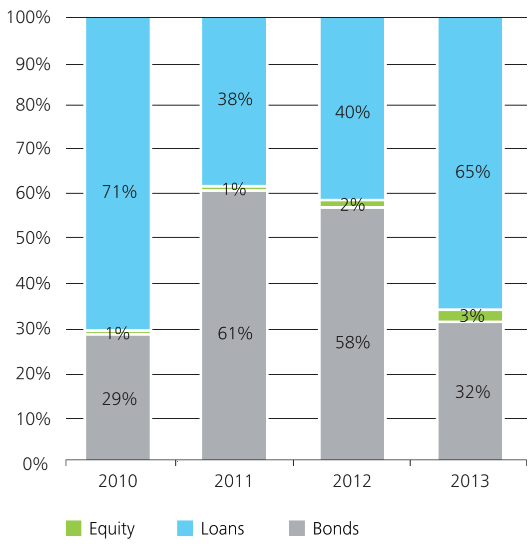
Structure of Private External Financing in selective economies in 2013



Source: Global Financial Stability Report, IMF, Statistical appendix, 2014

*UAE used, as rating for Dubai is not available

Structure of Private External Financing in the UAE during 2010 - 2013



Source: Global Financial Stability Report, IMF, Statistical appendix, 2014

Overview of recent developments in the debt market

Issuance of conventional bonds and Islamic Sukuk in the GCC

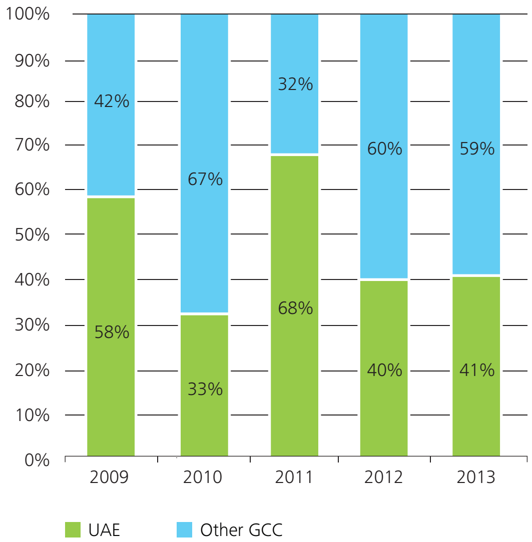
The UAE has been the first issuer of conventional bonds and Sukuk in the GCC for many years. In 2013, new issuances made by the UAE accounted for nearly 41% of total new issuances in the GCC with nearly USD 19 billion of bond and Sukuk issuances. However, when accounting for issuances of treasury bills, notes, bonds and Sukuk denominated in local currencies and issued by GCC central banks, the share of UAE in the total debt issuances of GCC countries drops significantly as the central bank of UAE does not issue these types of papers.

The UAE has been the first and largest issuer of conventional bonds and Sukuk in the GCC for many years

Bond issuances in the UAE

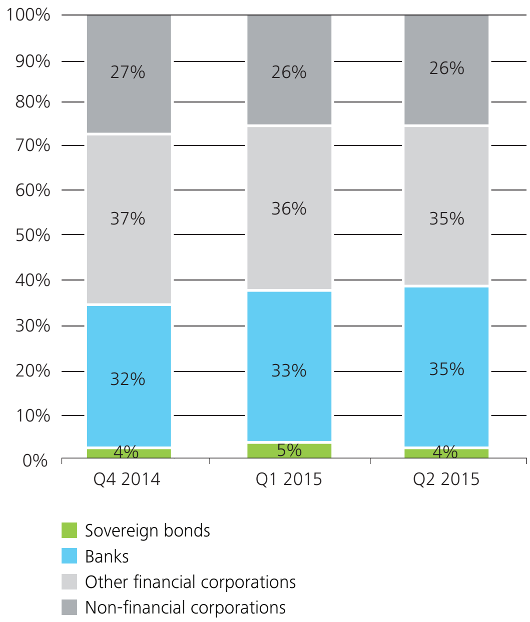
Bond issuances by corporates, including sovereign bonds, banks and other financial corporations, account for the majority of debt issuances in the UAE, with nearly 96% of total issuances made by banks, financial and non-financial corporations.

Issuance of conventional bonds and Islamic Sukuk, 2013



Source: Bloomberg and Kuwait Financial Center "Markaz"

Bond issuance by entity type in the UAE



Source: Bank of International Settlements

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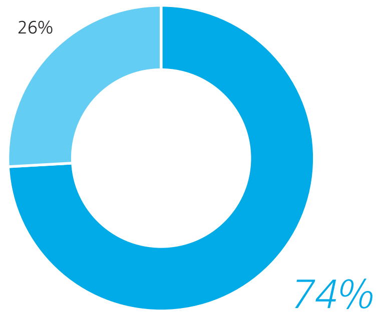
On the other hand, issuances in Dubai represented about 72% of total bond issuances in the UAE in 2014, of which issuances by banks and DIFC corporates comprised approximately 74% as opposed to 26% issuances by the Government and GREs.

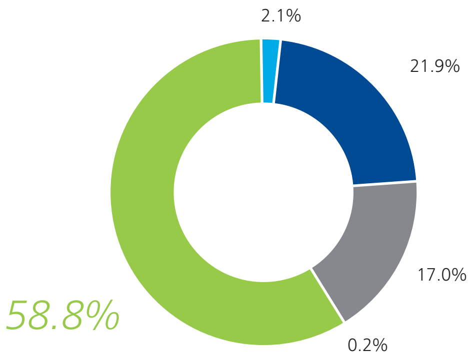
Bond issuances in Dubai by sector in 2013



Source: Bloomberg

Moreover, approximately 58% of these new issuances were denominated in USD followed by CHF (22%) and EUR (17%), while the issuances in AED represented just 0.2% of the total debt issuances.

Issuances in Dubai by currency



Source: Bloomberg

Dubai has become the world leader in the Islamic bond market with USD 36.7bn nominal value of listed Sukuk in 2014

Sukuk issuances

On the Sukuk issuances, recent statistics suggests that Dubai has become the world leader in the Islamic bond industry overcoming all its rivals with a USD 36.7bn nominal value of listed Sukuk in 2014. NASDAQ Dubai accounts for most of the Sukuk listings (93%), with a very small percentage listed on DFM. The UAE Government or related entities were involved in 56% of total Sukuk listings in Dubai, while Saudi Arabian issuers accounted for 22% and Indonesian issuers 16%.[1]

Sukuk issuance levels in 2014

UK and Ireland
USD 25bn each

Dubai
USD 36.7bn

Malaysia
USD 26.6bn

Benchmarking analysis

Overview

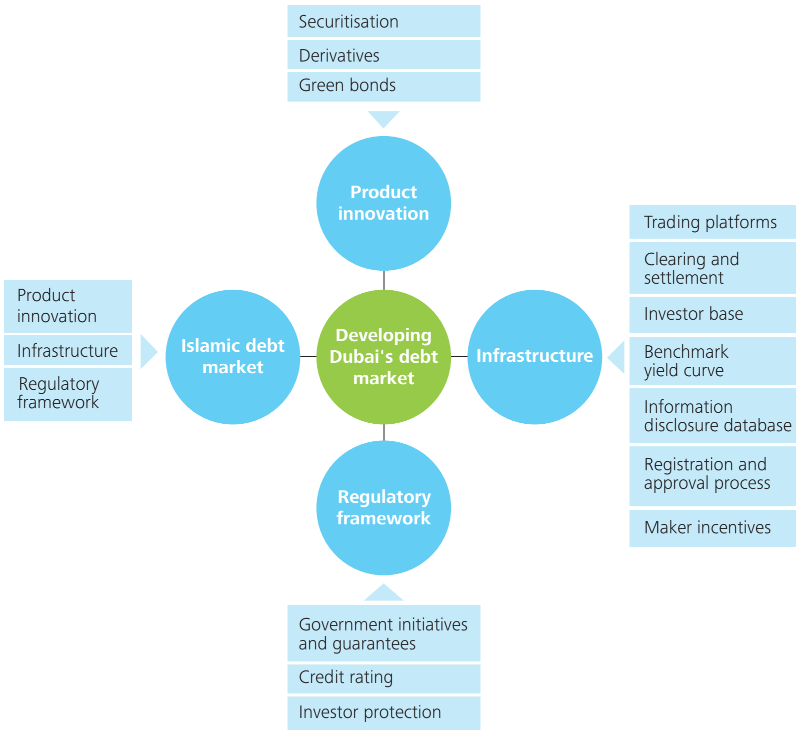
The benchmarking analysis performed compared Dubai against global financial hubs in order to identify gaps and improvement opportunities in conventional and Islamic debt markets. The key benchmarks selected for the conventional debt market include global financial hubs that share similar characteristics with Dubai, but are perceived as more established. The benchmarks selected for the Islamic debt market are those that have been developing an Islamic finance capability over the last few years and are in direct competition with Dubai. The benchmarks selected include:

- Conventional debt markets: New York, London, Singapore, Hong Kong, Riyadh and Manama; and
- Islamic debt markets: Kuala Lumpur, London, Riyadh, Doha and Manama.

The adjacent diagram summarises the key factors and areas that were considered in the analysis performed.

Support product innovation to increase market liquidity

The development of new debt products enables the debt market to function efficiently by providing issuers with a range of alternative instruments to raise capital and offer investors the option to manage their investment portfolios more effectively. In addition, new innovative and diversified products, such as hedging instruments could support both investors and issuers in managing risk more effectively and thus further support market liquidity.



A four pillar framework analysis was followed to benchmark the development of Dubai's conventional and Islamic debt markets against peer global and regional financial hubs

This section provides an overview of the different products in the conventional debt market within Dubai and the benchmarked jurisdictions.

Dubai is well positioned compared to other cities in the region with regards to the variety of debt products available in the market

Based on current levels of development, the Dubai debt market appears to have adequate debt instruments in place considering the current state and size of the market, with the potential of including derivative products on its exchanges. Dubai compares relatively well compared to other cities in the region with regards to the variety of products available. Singapore, Hong Kong, London and New York offer a wider variety of products with some derivatives traded on their exchanges, however, debt market size is higher with greater investor demand.

The table below summarises the debt products on offer in benchmark markets.

Product innovation benchmarking

Products	Dubai	New York	London	Singapore	Hong Kong	Riyadh	Manama
Covered bonds	Well developed	Under-developed	Well developed	Under-developed	Not available*	Not available*	Not available*
Derivatives							
Interest rate swap	Available but not on exchange	Available on exchange	Available on exchange	Available but not on exchange	Available on exchange	Available but not on exchange	Available but not on exchange
Interest rate futures contract	Available but not on exchange	Available on NYSE Euronext	Available on exchange	Available on exchange	Available on exchange (OTC clear)	Available but not on exchange	Available but not on exchange
Currency swap	Available but not on exchange	Available on exchange	Available on exchange	Available but not on exchange	Under development-Central clearing by the OTC Clear exchange	Available but not on exchange	Available but not on exchange
Currency future/forward	Available but not on exchange	Available on exchange	Available on exchange	Forward available on exchange	Under development-Central clearing by the OTC Clear exchange	Available but not on exchange	Available but not on exchange
Government derivatives							
Government bond futures contract	Not available	Available on NYSE Euronext	Available on ICE exchange	Available on exchange	Available on exchange	Not available	Not available
Green bonds							
Green bonds	Not available	Available on exchange but further development of regulation required	Available on exchange but further development of regulation required	Available on exchange but further development of regulation required	Available on exchange but further development of regulation required	Not available	Not available

*product not used

Covered bonds

Following the global financial crisis in 2007, demand for covered bonds was higher than Asset Backed Securities (ABS) and commercial and residential mortgage securities due to the perceived lower risk.

Covered bonds - similar to ABS - use a pool of assets as collateral, however in addition to the claim over collaterised assets, the investor has a claim over other assets held by the issuing entity. Nevertheless, the liability of covered bonds remains on the issuer's balance sheet even if the assets covering the bond are transferred to another entity. Covered bond holders have priority over assets in the event of an issuer default.

The UK covered bond market was established in 2003 with the issuance of a relevant regulatory framework. In the US, regulation for covered bonds was introduced in 2008, however market activity gained momentum in 2010. Regulation in the US does not currently permit US entities to issue covered bonds to US investors, with only foreign entities permitted to target US investors.

In January 2014, the UAE financial market regulator SCA, issued new regulations on the issuance, listing and trading of covered bonds, to support the development of the local debt market. The new regulations define the requirements to obtain a license to issue covered bonds, and prescribe disclosure requirements for issuers. Singapore set up a regulatory framework for covered bonds in 2014, however some market participants note a lack of detail in the framework.[2]

Riyadh announced in 2015 that it was planning to develop a securitisation platform to increase alternatives for issuers with lower credit ratings, whilst Hong Kong has not yet introduced regulation for covered bonds.

Derivatives

Traditionally, derivatives in the American and European markets have been traded over the counter but following the global financial crisis, the majority of markets agreed on improved regulation to monitor this segment, shifting towards electronic trading platforms (primarily for standardised derivatives) in order to increase transparency.

However, given the costs involved in shifting to an electronic platform, less developed markets have yet to adapt such a platform.

A number of derivative products, such as interest rate swaps, currency swaps and interest rate future contracts are offered by banks in the GCC, however, these instruments are not traded on their respective exchanges, unlike more developed markets such as New York and London, whilst Singapore only has interest rate and currency futures on its exchange.

Hong Kong is currently developing a platform to enable trading and clearing of currency swaps and futures on the "OTC clear" exchange.

Government bonds future contracts

Derivatives, such as interest rate futures and Government bond futures are used by a number of countries to support investors in hedging their positions and ultimately, attracting further investment and creating liquidity.

Derivatives such as interest rates, currency swap and future contracts are offered by banks in the GCC but not traded on the exchange due to lack of demand

Unlike more developed conventional debt markets, Government bond futures have not been issued by developing markets, such as Dubai, Riyadh and Manama primarily due to the lack of demand.

Singapore offers Government bond futures (5-year USD 100,000 face value at 3% coupon rate) which are traded on Singapore's exchange. Similarly, Hong Kong Government futures are available on the Hong Kong Futures Exchange.

Green bonds

Corporate green bonds recorded growth in 2013, primarily in the European and the American market. Total green bonds global issuance during 2014 amounted to USD 36.6 billion and may potentially reach USD 50 billion in 2015.[1]

Development of the global Green bond market would require standardisation of what constitutes a Green bond and market transparency on how proceeds are used

In 2015, the London Stock Exchange (LSE) launched a platform and framework for the issuance and trading of green bonds, whereby the issuer is required to receive third party clearance with a specific qualification to verify the nature of the bonds. The first Indian Green bond was listed on the LSE one month after the bourse announced the opening of the platform.

Hong Kong's first green bond (USD 300m) was issued in July 2015 on the Hong Kong exchange, whilst the first Asian Pacific green bond was listed on the Singapore exchange in 2014, potentially signaling the emergence of the green bond market in Asia.

The key area of focus in the development of the Green bond market would be to standardise what constitutes a Green bond issue and transparency on how proceeds are used. For example, leading regulators may encourage the assurance of a green bond issue by external third party certifiers and develop an effective regulatory framework with regards to monitoring and reporting on where the proceeds are deployed.

In the GCC demand for green bonds has yet to reach substantial levels so as to justify the introduction of such instruments and regulations.

Improving the underlying infrastructure to support issuance and trading

An efficient market infrastructure can be assessed through the following main pillars:

- **Trading platforms:** The availability of efficient trading platforms lowers trading costs and price volatility, reduces market fragmentation, facilitates order flow, improves price discovery and ensures wide dissemination of information.
- **Clearing and settlement:** Reliable clearing and settlement systems allow for cost and time efficient execution of transactions.
- **Investor base:** A wide and diverse investor base leads to increased liquidity and inspires confidence, allowing for a broader range of products to cater for investor requirements.
- **Benchmark yield curve:** The ability to develop a benchmark yield curve from Government bond issuances can facilitate the efficient pricing of credit risk for investors and corporates.

- **Information disclosure database:** An efficient platform and database for information disclosure of issuers and trades can enhance transparency in the market, and in turn, encourage both local and foreign investor participation.
- **Registration and approval process:** A time efficient registration and approval process supported by an effective regulatory environment could further promote fast and efficient bond issuance levels.

Trading platforms

ETM, OTC and ETP platforms

Different trading platforms facilitate the issuance of both public and private placements of trades. The most commonly used platforms include the Exchange Traded Markets (ETM), Over the Counter (OTC) and Electronic Trading Platforms (ETP).

Whilst ETMs are commonly used in developed markets, emerging markets primarily use OTC platforms given the dynamics of the transactions and investors within the market. Bond transactions in Dubai and Hong Kong are largely executed through OTC platforms as they are typically large and tend to be traded by institutional investors who prefer to negotiate directly with the counterparties.

ETPs are becoming increasingly popular for transactions involving more standardised and low risk corporate bonds, such as investment grade bonds. Developed markets, such as New York and London have a fully automated electronic trading platform that allows bond trading for institutional and retail investors while offering trading platforms for non-conventional products, such as derivatives. Manama, Dubai and Riyadh have taken steps towards the implementation of ETPs in their respective bond markets. The Bahrain bourse recently implemented the Automated Trading System ("ATS") platform that allows electronic execution of transactions. Riyadh is in the process of implementing the X-stream INET Trading platform by NASDAQ to allow electronic trading of Sukuk and conventional bonds, whilst NASDAQ Dubai has implemented the same technology.

The availability and efficiency of electronic trading platforms can support increased market liquidity

The ETP, with its combination of electronic trading and centralised price dissemination, can provide bond dealers with a more complete and efficient platform for cost competitive trade execution. It can also lead to more effective price discovery and greater access by a wider range of investors.

The introduction of an ETP will need to be in parallel with enhanced market liquidity, as such platforms have relatively high implementation and maintenance related costs, and as such, economies of scale through large transaction volumes will need to be achieved in order to justify such costs.

Other steps towards developing the market infrastructure and increasing market liquidity might include the introduction of new platforms or expanding the current platforms to allow:
- Connectivity with other regional and international markets and brokers' systems;
- Introduction of derivative products;
- Access to retail investors; and
- Efficient trading hours.

Connectivity with other markets, introduction of derivative products, access to retail investors and offering of efficient trading hours represent key elements to the development of trading platforms

Connectivity

Connectivity between domestic, regional and international platforms could offer easier and automated access to various stakeholders including brokers, dealers, issuers, and local and foreign investors as witnessed in the developed market. These markets have expanded their infrastructure to accommodate connecting systems with other exchanges and platforms. For example, the New York Stock Exchange (NYSE) offers the option to connect directly through the FIX gateway to all NYSE Euronext markets (Amsterdam, Belfast, Brussels, Chicago, Lisbon, London, New York, Palo Alto, Paris and San Francisco). It also offers connection to Bloomberg's Trade Order Management System (TOMS) and InterDealer, which gives access to cross-asset trading platforms across the NYSE.

On the other hand the DFM operates an order-driven automated screen-based trading system where investors can place their orders through DFM's accredited brokers, who then place these orders on the exchange's system. The system automatically matches buy and sell orders of a particular security based on price and quantity requirements similar to the trading system implemented in Riyadh where brokerage firms' systems are also connected directly with the exchange (Tadawul) system.

Platforms for derivative products

The availability and ability of platforms to accommodate other non-conventional products, such as derivatives is also key in driving market liquidity in order to meet investor demand. This is primarily witnessed in New York where the NYSE offers direct access to a wide international network of derivative exchanges and clearing houses through the Intercontinental Exchange (ICE).

The London Stock Exchange continues to develop its market by introducing dedicated ETC segments and connection with the stock exchange derivatives markets. In an attempt to follow suit, Bahrain introduced the Bahrain Financial Exchange ("BFX"), which was established as a multi-asset exchange to list derivatives and cash instruments on multiple asset classes, such as currencies, commodities and securities for trading. Bait Al Bursa is an Islamic finance division of the BFX exclusively offering electronic exchange traded Islamic financial instruments.

In Dubai, NASDAQ Dubai launched a derivatives trading platform in 2008 limited to equity derivatives, such as stock futures and options.

Retail investors

Targeting retail investors promotes trading of debt products while expanding the investor base and improving market liquidity. The LSE launched the electronic Order book for Retail Bonds (ORB) platform in 2010 to offer retail investors access to primary issues through distributors as well as enable online secondary market trading in Government and corporate fixed income securities.

In Singapore, retail investors were provided access to the Singapore Government Securities primary market in 2009, and the secondary market in 2011 via the Singapore Exchange (SGX).

Bahrain has launched direct sales of local currency Government debt through its securities exchange, in an effort to broaden the investor base of its debt. Local and foreign investors can now acquire Government bonds and Sukuk from the primary market via licensed brokers at the Bahrain Bourse.

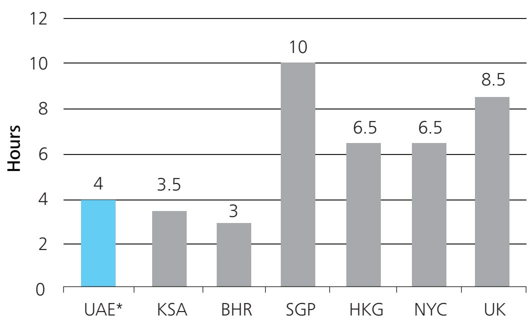
In Dubai, there is no current platform for retail customers. However, NASDAQ Dubai announced plans for the establishment of a platform to sell bonds and Sukuk directly to retail investors, expanding the primary market beyond institutional buyers.

Trading hours

Trading hours can have a significant impact on a market's liquidity, trading activity, pricing and volatility. Dubai's markets (DFM and NASDAQ Dubai) currently trade for four hours on the weekdays, which is longer compared to the regional markets, such as Riyadh and Manama, but shorter compared to the more developed markets of New York and London. Extended hours could provide foreign investors in different time zones access to Dubai's markets.

The chart below summarises the daily trading hours of benchmark markets. As a matter of best practice, and taking previous factors into consideration, it is recommended that trading hours are increased when sufficient demand exists and when it becomes cost effective to do so.

Trading hours



Source: Exchange websites and publicly available information

*NASDAQ Dubai and DFM

Clearing and settlement

Centralised clearing and settlement systems inspire confidence in the bond markets and ensure that the settlement of transactions between market participants is made in an orderly and timely manner.

In such a system, a central counter party oversees transactions leading to reduced risk for market participants through the multilateral netting of trades and effective risk controls. The establishment of a central counter party improves the overall infrastructure of the bond market given effective design of associated risk controls and adequate financial resources. Such systems have been widely used by exchanges around the world including the benchmark markets selected.

Dubai exchanges have made a number of improvements to their clearing and settlement systems in the last few years to enforce control by local custodians over client accounts. NASDAQ Dubai uses a Central Securities Depository (CSD) and settlement platform where securities are held in electronic form. It also provides international investors access through links with international CSDs, such as Euroclear and Clearstream, which have a global presence in most exchanges around the world including the subject benchmark markets selected. Similarly in DFM, all exchange transactions in listed securities are instantly sent through the Automated Trading System to the Automated Clearing and Settlement System for completion of the clearing processes.

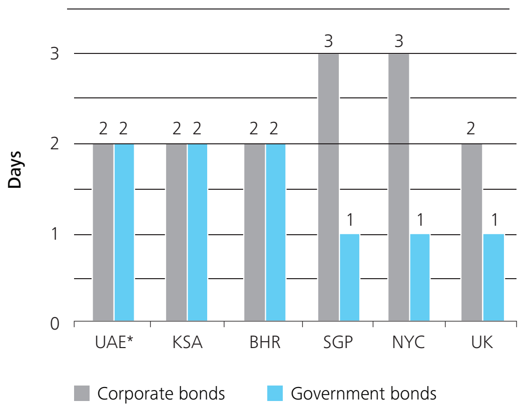
Increasing Dubai's markets' trading hours in line with international markets could allow for increased foreign and local investors' participation

Settlement cycle

Settlement cycles have reduced considerably over the past decade with the introduction of new technology and the improvement and automation of clearing and settlement systems. Settlement cycles differ in each market, however the international market practice is considered to be 2 days (T+2) and markets are moving towards this, as shortened cycles allow for:

- A reduction in credit, counterparty and settlement risk;
- An increase in the ability to manage capital and also increases market liquidity; and
- An increase in the speed and accuracy of post-trade processing.

Settlement cycle on a T+ ( ) basis



Source: Exchange websites and publicly available information

*NASDAQ Dubai and DFM

Growing the institutional and retail investor base together with primary issuance levels could further grow Dubai's debt market

Trades in Dubai's exchanges are settled on a Delivery versus Payment basis (DVP) with a T+2 settlement period for both corporate and Government bonds. Benchmarked markets, such as London, Bahrain and Saudi Arabia use a two day settlement period while New York and Singapore exchanges operate on a T+3 basis, whilst for the Hong Kong exchange the cycle can vary. The settlement cycle for Government bond trades is shorter at T+1 for more developed markets, such as Singapore, New York and London. Dubai may decrease the settlement cycle for Government bond trades, once the market reaches a justifiable size.

Investor base

The size and diversity of the investor base is a critical factor and a driver for the development of a liquid bond market.

Institutional investors can facilitate efficient pooling of long-term funds, risk mitigation, diversification and product innovation. Foreign institutional investors can introduce market best practices leading to improved governance, disclosure standards and procedures. Similar to New York and London, Dubai allows foreign investors to trade on their exchanges.

The growth of the investor base is also affected by the risk appetite and the profit seeking attitude of investors in each respective market. Risk-averse investors are more willing to settle for lower yields and steady income offered by bonds as compared to less stable equity investments which could offer less steady income but potentially higher capital appreciation potential.

A study conducted in 2011 by the emerging market committee of the International Organization of Securities Commision "IOSCO" highlighted that global corporate bond markets tend to attract institutional investors with less participation from retail investors.[3]

Institutional investors in some markets are required by authorities to hold a certain proportion of their assets in Government bonds leading to increased demand. However, these requirements are often driven by favourable tax treatments, as compared to other type of investments such as corporate bonds or equities. In Dubai, favourable tax treatments might not act as a decisive factor for investors choosing between different types of investments given that the markets are operating under a tax free environment.

Product innovation attracts various types of investors leading to a wider investor base as mutual funds, corporates and retail investors tend to invest in equities whereas pension funds, more risk-averse retail investors and banks lean towards investment in bonds.

NASDAQ Dubai is currently planning to introduce a platform to target retail investors in an effort to increase market liquidity.

Benchmark yield curve

An effective Government benchmark yield curve is important for Government and corporate bond markets as it provides an index for the pricing and valuation of various debt instruments, such as corporate bonds.

Developing an effective benchmark yield curve would require Governments to establish an adequate debt management programme and issue bonds at various maturities/tenors to broaden the maturity profile and allow for greater visibility across various time periods.

Without an efficient benchmark yield curve, pricing of bonds in the primary and secondary markets may be constrained. The table below summarises the available Government bond maturities issued and whether an issuance calendar is in place across the benchmark markets.

Dubai might currently find it challenging to build an effective benchmark yield curve given the limited number of Government bonds issued to date, the lack of an issuance calendar to provide investors with additional visibility of planned issuances and the limited tenors available where the existing issues only cover 5, 10 and 30 year maturities, leading to difficulties in extrapolating the yield curve.

Government bond maturities and issuance calendar benchmarking

Criteria	DXB	SGP	HKG	NYC	UK	KSA	BHR
Government bond tenors available	5Y,10Y, 30Y	1Y, 2Y, 5Y, 10Y, 15Y, 20Y, 30Y	2Y, 3Y, 5Y, 10Y, 15Y	2Y, 3Y, 5Y, 10Y, 15Y	1Y, 2Y, 5Y, 10Y,15Y, 20Y and 30Y	7Y, 10Y	2Y,3Y, 5Y, 7Y, 10Y
Number of Government bonds issued from Jan'15 to Jun'15	-	10	42	4,300	22	12	13
Issuance calendar	✗	✓	✓	✓	✓	✗	✗

Dubai could increase the issuance of Governmental bonds across additional maturities, as well as introduce an issuance calendar to further support bond pricing

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Information disclosure database

A suitable database enables the disclosure and presentation of information, such as trades executed and issuers' information and can enhance transparency and investor protection by making related information more accessible to investors. Investors will thus be better placed to understand the credit risk of corporate issuers and price bonds to support investment decisions.

Such information is usually made available on the stock exchange's website. In some markets, the information is also published on dedicated automated systems that make it easier for investors to access. However that depends on the regulatory and oversight agencies in place and the level of transparency in each market.

Dubai could further enhance market transparency by developing a complete database of bond holders

A survey conducted in 2011 by the emerging market committee of the IOSCO on the development of corporate bond markets in emerging countries, shows that only half of the markets have a centralised information system for historical trade data as well as complete databases of bond holders. The survey also revealed that Dubai and Malaysia, despite having a large corporate bond market, do not have complete databases of bond holders.

Some developed markets have a higher level of transparency in their corporate bond markets due to the introduction of trade reporting and trade publication systems which typically keep a comprehensive database for investors while enhancing regulators' ability to monitor the corporate bond market activity. New York introduced Trading Reporting and Compliance Engine (TRACE), a system that facilitates the mandatory reporting of OTC secondary market transactions in eligible fixed income securities to enhance price transparency. In addition the New York, London and Hong Kong markets offer issuers the ability to electronically disclose listing information.

In Dubai, trading information is usually disclosed on the exchanges' website. NASDAQ Dubai provides listed entities with an efficient email-based software system, CANDI, through which they can make disclosures, such as financial results to the market as required by the Dubai Financial Services Authority (DFSA) and other information of interest to investors. Disclosures sent through CANDI appear on NASDAQ Dubai's website and can be sent directly to brokers and media outlets such as Bloomberg.

Registration and approval process

A corporate bond issuance process usually involves a comprehensive registration and approval process. An effective process may require an approval framework as implemented by the regulator, a primary market offering mechanism and requirements for the issuer to submit relevant documentation such as a detailed prospectus for the bond issue.

In some countries this process is more time consuming than others attributed to inefficiencies in the approval framework, such as multiple approval authorities, duplication of disclosure requirements and lack of relevant disclosures.

The approval process can last longer in markets where regulators use a merit-based approval regime to review and approve corporate bond issuances. A merit based review requires a comprehensive assessment by the regulator to determine the merit of the bond issuance. Whilst this approach has its benefits by enforcing better control and driving a higher quality bond issue, the additional time and issuance costs could lead issuers to revert to other less demanding funding options.

In an effort to speed up the process, some markets have been trying to address this challenge by tailoring different approvals and registration criteria depending on the type of issuers.

The processing and approval timeframe varies from market to market where it may take up to 5 days for professional investors in Hong Kong, 7 days in London and 4 to 12 days in Singapore. NASDAQ Dubai however, seems to require more time to process and approve an issuance as it could take up to 16 days (8 days for admission by the DFSA and 8 days admission to NASDAQ Dubai).

Nevertheless, some steps have been taken by authorities in Dubai to address this issue whereby in 2014 the Securities and Commodities Authority ("SCA") issued new regulation on Sukuk and conventional bonds to support issuance and trading. As part of this regulation the SCA announced that it would shorten the time to approve issuance application to five days while private placements not listed on the UAE's exchanges would not need SCA approval.

The SCA also introduced the debt securities issuance programme to allow for a fast track process for regular issuers, in an effort to reduce further the approval cycle.

Market making incentives

Market Makers are vital for the efficient operation of the security markets. A market maker holds a number of securities on their balance sheet and displays buy and sell prices, thus enhancing market liquidity on the exchanges as well as supporting investors in valuing securities. In 2012, the SCA approved market making regulation, with the objective of increasing market liquidity.

In addition, exchanges need to provide the incentives to market makers to attract them. Nasdaq Dubai for example offers market makers a 100% rebate on trading and clearing fees to encourage participation and improve liquidity. The exchanges of the some of the benchmark cities also provide incentives to market makers in an effort to increase liquidity in some securities, in the form of the obligations that market makers have, limits on bid-ask spread and rebates on transaction. For example, the NYSE allows market

Shortening the registration and approval process for bond issues could further support market growth

makers to quote at the best bid or ask price at least a portion of the day, whilst Nasdaq OMX's US and the LSE do not impose any limits on market makers with regards to the quoted bid-ask spread. The Hong Kong Securities Exchange offers market makers reduced transaction fees for primary issues and has eliminated the transaction fees for market making of Exchange Traded Funds. Similarly, Singapore's exchange (SGX) offers market makers rebates on clearing fees and higher rebates for more illiquid securities.

DFM is currently limited to the incentives given to market makers as it doesn't offer any rebates on transaction fees and also some of its requirements impose limits to market makers with regards to the number of transactions and number of securities traded. For example, one of DFM's requirements is that a market maker can provide liquidity if the number of transactions executed on the security are less than 150 transactions over a six month period.

Legal and regulatory framework

Developing an effective regulatory framework is important in driving further depth and confidence in the bond market and encouraging issuers and investors to participate and inject liquidity.
An effective framework is likely to address the following areas:

- Credit rating requirements,
- Investors protection; and
- Government initiatives and guarantees.

Credit rating

Given the private nature of some corporate issuers in emerging markets, particularly in Dubai, credit rating agencies may play an important role in helping investors better analyse credit risks of corporate bond issuances.

Most of the regulators of developed bond markets around the world have mandatory requirements to obtain ratings of corporate bonds pre and post issuance. Moreover, credit rating agencies can act as an independent and additional source of information on the credit-worthiness of the issuer, particularly in emerging corporate bond markets. It can also offer a mechanism to ensure that issuers adhere to the terms and conditions of the issue.

Despite its important role, credit rating has lost some of its popularity in the aftermath of the international financial crisis following some controversial ratings by credit rating agencies that failed to detect the deterioration in credit quality, particularly for asset-backed and other structured products. In some cases, the drivers behind these ratings were attributed to:

- Conflicts of interest;
- Inability of some credit rating agencies to fully comprehend complex bond structures;
- Weak objectivity of the rating process;
- Lack of transparency of rating criteria;
- Inadequate supervision of these agencies; and
- Overreliance of investors on credit ratings issued without independent due diligence.

Many markets have eliminated mandatory credit rating in an effort to reduce costs, however independent due diligence by investors is still critical

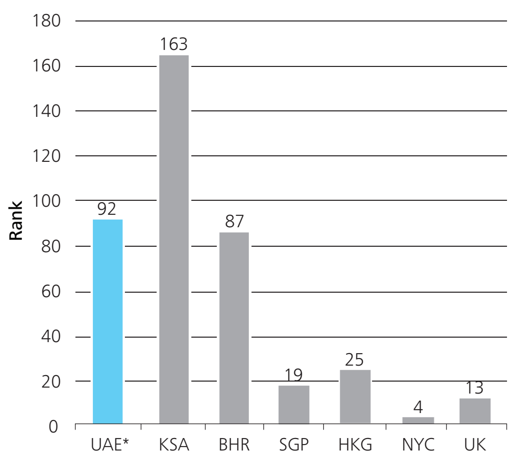
In light of these constraints and in an effort to reduce costs, some capital markets have begun considering making credit ratings optional rather than mandatory. In 2014, the UAE's SCA announced that it is no longer mandatory to obtain credit ratings from rating agencies, which is expected to remove a major expense for issuers by making it more cost and time effective. As a comparison, London does not require credit ratings for bonds issued to retails investors through the Order book for Retail Bonds (ORB) platform.

Nevertheless, the availability of credit ratings, even if this is not made mandatory, remains critical to add transparency to the bond market and encourages investor participation by providing a vehicle for credit risk assessment of issuers. This is rendered even more important in a market dominated by privately held corporates where investors have limited access to the corporates' financial information.

Investor protection

Some of the major risks that bond investors need to consider and mitigate are the risks of default and legal arbitrations. One of the benchmark indices that measure the effectiveness of regulation with regards to investors' protection is the "Resolving Insolvency" index, issued by the World Bank in its 2015 "Ease of Doing Business" report. The chart below shows how each benchmark city ranks against this index, out of 189 countries, where a lower ranking indicates a more developed environment for resolving insolvency:

Resolving insolvency index – ranking out of 189 countries



Source: Ease of doing business report – 2015, World Bank
*UAE used, as rating for Dubai is not available

Bankruptcy and restructuring regulations

At present there are opportunities to further develop bankruptcy and collateral laws to improve protection for distressed businesses as well as creditors. UAE ranks low compared to the other benchmarking markets due to existing bankruptcy law procedures not meeting international standards. Current regulations are perceived to be weak for supporting businesses facing difficulty in meeting payments, with bankruptcy cases and bounced cheques often carrying criminal implications.

The UAE is currently in the process of introducing and implementing a new bankruptcy law which is expected to follow international standards and best practices, such as Chapter 11 law in the US, and may remove the criminal implications for bankrupt companies. Under the new draft law, companies should be able to apply for support and protection prior to default. The new bankruptcy system is designed to safeguard viable companies but also support creditors prior to recovering their funds and assets.

Arbitration regulation

Dubai has the opportunity to improve further in areas of dispute resolution and arbitration resulting from issuer defaults to reach the level of other global leaders, such as New York and London. Alignment of regulation to international arbitration standards could improve Dubai's efficiency in settling disputes. Dubai is currently establishing a new legal framework to allow for increased transparency and alignment to international regulatory standards.

Government initiatives and guarantees

Introduction of new regulations and rules

As part of its efforts to improve and grow Dubai's bond markets the SCA introduced new regulations regarding the issuance and trading of Sukuk and conventional bonds in 2014. The regulation changed the rules for lending and borrowing securities, including bonds, to facilitate borrowing between parties. For example, brokerage companies are allowed to borrow securities without SCA's approval in order to reduce the risk of a trade placed by an investor through a broker not being completed due to lack of liquidity.
In addition, new regulation allows foreign investors to lend and borrow securities as an additional step in encouraging foreign investment in the UAE markets.

Aligning agendas of various regulatory authorities

Establishing a national agenda in the UAE in line with Dubai's efforts to develop the bond market might help in demonstrating the commitment of the Government to guide long-term development of the bond market, thereby inspiring confidence in local and foreign investors.

The achievability of this will be predicated on having a dedicated panel of Government, regulatory authorities (including central bank representatives) and industry experts addressing the various challenges to the development of a bond market, and aligning the respective priorities and agendas of the various authorities for the purpose of having a strategic long-term plan.

Dubai could further support the growth of its debt market by enhancing its bankruptcy and arbitration regulation to align it with international standards

Some UAE authorities have already made direct intervention in driving the development of the local bond markets. In 2014, the Central Bank of the UAE announced a revision to its banking regulations, capping concentration limits on the amount of credit that domestic banks can extend to local Governments and their related entities. These loans are now capped at 100% of the lending bank's capital base. Assertive implementation and monitoring of these rules should support the growth of debt markets, encouraging a number of Government-related entities to look towards the conventional bond and the Sukuk market for funding or refinancing.

In addition, the implementation of other international liquidity and risk management regulations, similar to Basel III and other capital requirements, may have a material impact on the bond market and will need to be considered and encouraged as and when appropriate. This has already been demonstrated with the UAE recently introducing regulations in line with Basel III to manage liquidity risk of financial institutions through monitoring of liquidity risk ratios and the introduction of a liquidity risk management framework. This may drive financial institutions to seek low risk short-term investments, which may come in the form of short-term bonds and fixed income instruments.

The implementation of risk management and liquidity regulations, in line with international standards, could further support the development of the local debt market

Introducing state pension schemes

The introduction of pension state schemes could support an increase in the establishment of pension funds, which could subsequently act as vehicles for deepening the bond market.

Introducing a state pension scheme for skilled foreign workers that meet specific criteria, in combination with easing retirement visa restrictions, may result in a higher number of expatriates choosing to remain longer in Dubai and investing their savings within the local market rather than abroad.

In addition, a pension scheme will often require a certain portion of the investments to be made in low risk assets, such as Government bonds, which in turn, drive further investments of the bond market. Singapore and Hong Kong have introduced state pension schemes for expatriates with the aim of retaining human capital and savings within the country. Hong Kong's Mandatory Provident fund extends to expatriates who are granted permission to work in Hong Kong for over 13 months while Singapore's Central Provident fund extends solely to expatriates with permanent residency.

A proposal to the UAE Government has been made by Dubai to suggest the creation of a UAE Sharia'a-compliant retirement savings scheme for foreign workers, a step which could help develop the Islamic bond market and provide additional funding to the industry.

Setting up specialised third-party guarantee institutions

Establishing third party guarantee institutions similar to those made available in more developed markets could increase market participation and provide a boost to the local bond market. This may help introduce lower-rated issuers to the marketplace and thus widen the issuer base as well as diversify the product range.

An important factor in establishing financial guarantee institutions is to ensure adequate financial strength and intellectual and risk management resources are available to support the credit risk inherent in these guarantees. This initiative may be supported by the Government to add stability and provide confidence in these institutions.

Islamic debt market

Sukuk instruments, more commonly known as Islamic bonds, differ from conventional financial products on account of Sharia'a prohibitions on interest (Riba), gambling or speculation (Maysir), unnecessary risk (Gharar), short selling and trading in products deemed incompatible with Sharia'a law (e.g. alcoholic drinks, weapons, adult entertainment).

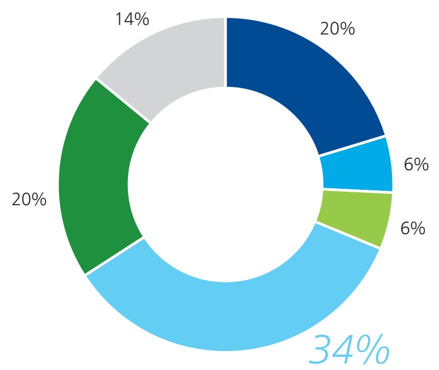
Following the global financial crisis of 2007, non-Islamic and developed countries began to participate in the Sukuk market, including Singapore (2009), Hong Kong (2014), UK (2014) and Luxembourg (2014).

In this section, Dubai is benchmarked against other global Sukuk markets including Kuala Lumpur, the GCC (Riyadh, Doha and Manama) and London - the western hub of Islamic finance. The analysis focuses on areas, such as regulation, product innovation and infrastructure, with the objective of outlining performance improvement measures for the Dubai market.

Product Innovation

Various Sukuk structures have been developed over the years to cater for the increasing demand for Sharia'a compliant products. Amongst these instruments, Murabaha (asset-based) is the most common structure, accounting for 34% of global Sukuk issues, followed by Ijarah (lease-based) and Musharaka, each representing a 20% share. Mudaraba (profit-sharing) is less common, accounting for approximately 6% of global issues.

Structures of outstanding global Sukuk issued (as at May 2015)



Source: Bloomberg, HSBC

The table below sets out the benchmarking results with regards to products that could be used to further enhance the Islamic debt market.

Product innovation benchmarking

	Dubai	Riyadh	Doha	Kuala Lumpur	London	Manama
Sharia'a compliant repurchase agreement	Not available (announced)	Not available	Not available	Under developed	Not available	Under developed
Sharia'a compliant derivatives						
Sharia'a compliant currency swap/forward	Available – swaps offered by banks	Available – swaps offered by banks	Available – swaps offered by banks	Available – Islamic currency forward	Available – swaps offered by banks	Available – swaps offered by banks
Sharia'a compliant profit rate swap	Available – swaps offered by banks	Available – swaps offered by banks	Available – swaps offered by banks	Available – swaps offered by banks	Available – swaps offered by banks	Available – swaps offered by banks
Green Sukuk						
Green Sukuk	Not issued (UAE announced plans)	Not issued	Not issued	Issued	Not issued	Not issued

Further development of the local Sukuk debt market, could enhance Dubai's position as the leading Islamic financial and trading hub

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Dubai could further increase the liquidity of the Islamic debt market through the introduction of a Sharia'a compliant repurchase agreement and additional product innovation

Sharia'a compliant repurchase agreement

Although Dubai's markets topped other global financial centres in terms of issuance levels in 2015, secondary market trading on exchanges - another important indicator of market health - has historically been low. One way to promote liquidity is by establishing an equivalent "Islamic" repurchase agreement (repo) facility to allow for the lending of assets at low rates between financial institutions. NASDAQ Dubai is planning to introduce such a product in 2016, whilst Bahrain introduced a contract template in November 2014. Malaysia has established an Islamic repurchase contract "inah," however, some market participants perceive the contract as not clearly defining the transfer of assets, which may be interpreted as contrary to Islamic finance principles, which stipulate the transfer of ownership between the parties.[4] Whilst Kuala Lumpur and Manama are the leading cities with regards to creating Sharia'a compliant repurchase agreements, they are subject to limitations as these are approved only at a domestic level, and collateral only includes local currency securities.

In August 2015, the National Bank of Abu Dhabi and the Abu Dhabi Islamic Bank conducted the GCC's first ever Sharia'a compliant repurchase agreement - a collaterised Murabaha transaction, strengthening the UAE's position regionally. The two banks defined a master collaterised Murabaha agreement, enabling the use of their Sukuk holdings as collateral.
To establish an effective Sharia'a compliant repurchase agreement in Dubai, an appropriate standardised contract template should be developed (with clear guidelines) as well as being endorsed by religious scholars. These guidelines should define a standard set of contractual terms and the type of Islamic Sukuk that may serve as collateral.

Green and Socially Responsible Investment Sukuk

In 2014, the Security Commission in Malaysia released a framework for the issuance of Sustainable and Responsible Investment (SRI) Sukuk with the objective of promoting socially responsible financing. SRI Sukuk are considered as the Sharia'a compliant equivalent of Green bonds.

Eligible SRI projects as prescribed under the framework aim to preserve and protect the environment and natural resources, conserve use of energy, promote use of renewable energy, reduce greenhouse gas emission, and improve the quality of life for society. Malaysia saw the first SRI Sukuk issued in early 2015, whilst the UAE announced in March 2015 that it is seeking to become the first country to issue a green energy Sukuk in order to finance renewable energy projects. Green bond issuance amounted to USD 36.6 billion in 2014 and may potentially reach USD 50 billion in 2015, illustrating the potential growth for an equivalent "Islamic" Green Sukuk market.[5]

Derivatives

The use of Sharia'a compliant derivatives, such as exchange rate and profit rate swaps may boost liquidity by allowing investors to hedge their positions and manage risk. Profit rate swaps are utilised to swap variable rate cash flows to fixed rate, and vice versa, whilst currency swaps could be used to hedge against foreign currency exposure. The availability of these instruments may drive participation of foreign Islamic institutions and investors by providing shelter through these mechanisms.

Malaysia makes use of Islamic foreign currency forward contracts to support investors in managing currency risk.

Islamic foreign currency swaps and profit rate swaps are also commonly utilised in the GCC and issued by banks, however these instruments are not traded on these exchanges.

Infrastructure

The table below highlights the benchmarking results with regards to areas where market infrastructure can be developed to support the Islamic debt market.

Malaysia is considered the most liquid secondary market, especially for Government Sukuk, characterised by a large number of small corporate issuers and a well-developed trading platform. Doha, Manama, Dubai and Riyadh have all established secondary Sukuk trading platforms, however these markets lack liquidity and trading transparency.

Whilst Riyadh established a Sukuk trading platform, in an effort to increase market liquidity, market participants note that further improvements with regards to central order bookings and trade reporting could be made.

Whilst all of the benchmark markets have established secondary Sukuk trading platforms, they continue to face low levels of trading

The market in Murabaha trading is estimated between USD 5bn and USD10bn, with the majority of trading taking place on London's Metal Exchange.[6] In a further effort to support liquidity, NASDAQ Dubai launched a trading platform for Murabaha (asset-backed Sharia'a compliant) instruments in 2014.

The NASDAQ Dubai's Murabaha platform has brought significant enhancements and efficiency to retail and institutional Murabaha financing, playing a growing role in Dubai's pursuit of becoming the Islamic banking capital.

Infrastructure benchmarking

Criteria	Dubai	Riyadh	Doha	Kuala Lumpur	London	Manama
Sukuk listing platform	NASDAQ Dubai (majority) and the Dubai Financial Market	Tadawul	Qatar exchange (new)	Bursa Malaysia	London stock exchange	Bahrain Bourse
Secondary Sukuk trading platform	Available	Available	Available	Available	Available	Available
Primary offering to Retail investors	Under-development	Not available	Not available	Available	Not available	Available

Kuala Lumpur and Manama are the only benchmark markets that have introduced a trading platform that allows for the primary sale of Sukuk' to retail investors.

Regulatory framework

The leading Islamic financial centres must ensure that they are regarded as "thought leadership" centres by establishing best-practice accounting standards, appropriate product regulation and innovative Sharia'a compliant financial structures.

In an effort to support further issuance and trading levels of Sukuk on the exchanges, the UAE's SCA regulator issued in 2014 new regulation with regards to Sukuk and conventional bonds, in order to provide guidance for issuers and investors, and ultimately minimise potential disputes. As part of these rules, the minimum listing size decreased from USD 50m to USD10m to attract more issuers.

Dubai, in some areas has taken the lead as compared to its competitors. In 2010, Dubai was the pioneer in making exemptions for double payment of registration fees on the transfer of title in Ijara transactions. London subsequently adopted a similar approach, removing the double payment of Stamp Duty Land Tax (SDLT) associated with Murabaha and Musharaka structures.

However, further opportunities for improvement exist in areas including best practice standard setting and dispute resolution.

The table below shows the benchmarking results with regards to areas where regulatory frameworks can be developed to support the Islamic debt market.

Further development of the regulatory framework would be key to promoting growth of the Islamic debt market

Regulatory benchmarking

Criteria	Dubai	Riyadh	Doha	Kuala Lumpur	London	Manama
Dispute resolution and bankruptcy regulation	Not developed	Not developed	Not developed	Developed	Developed	Not developed
Sharia'a board to oversee standards	Not available (announced plans at federal level)	Not available	Not available	Available	Not available	Not available (announced plans)
Primary sales of Sukuk to Retail investors	Not available (announced)	Not available	Not available	Available	Not available	Available

Best practice standards setting
Although Malaysia is considered the leading hub with regards to Islamic standards, some scholars perceive the Malaysian framework as relatively liberal and not fully aligned with Islamic principles.[7] In addition some market participants consider the Sukuk standards issued by the Bahrain-based Accounting and Auditing Organisation for Islamic Financial Institutions ("AAOIFI") to mainly focus on classifying types of Sukuk rather than clarifying whether they abide by Islamic principles.[8] However, AAOFI remains highly regarded with authorities, such as DFSA prescribing for AAOFI based audits on firms that claim to be Islamic.

In an effort to further enhance the Islamic financial market, the UAE announced in 2015 plans to establish a federal level Sharia'a board. The objective of this board is to pass decrees on whether financial products and transactions conform to Islamic principles. Malaysia established a similar board in 1997, whilst Bahrain is currently considering establishing such a committee.

In the UAE, Sharia'a scholars are permitted to sit on multiple boards. By comparison Malaysia has limited Sharia'a scholars to advise only one institution at a time in a particular market segment, thereby reducing potential conflicts of interest.

Sharia'a compliant regulation for settling disputes
Sharia'a compliant regulations for settling disputes are relatively underdeveloped in the GCC. Currently the majority of disputes are settled based on English Law with London considered the international arbitration centre.

Malaysia has made efforts in becoming a global arbitration centre for matters relating to Islamic transactions by setting up a special committee in 2010, with the aim of improving regulation, such as bankruptcy laws.

Whilst Dubai has established an arbitration body for Islamic finance disputes - the World Islamic Finance Arbitration Centre - further improvement opportunities exist with regards to drafting and implementing appropriate arbitration and bankruptcy regulations, to align with international standards

Primary sales to retail investors
Direct sales to retail investors could further support an increase in trading activity and market liquidity. NASDAQ Dubai announced in July 2015 that it plans to make direct sales to retail investors, whilst other markets, such as Bahrain have already offered this channel through their exchange, allowing direct sales to retail investors of local currency Government bonds and Sukuk via registered brokers. To encourage retail investors the Bahraini Bourse also set a minimum subscription of 500 dinars.

In 2013, Malaysia developed a framework which allowed the issuance of Government Sukuk and conventional bonds to retail investors on its exchange. The framework allows for retail investors to trade over-the-counter through a network of registered brokers and banks, however, secondary trading through the exchange remains unavailable. This framework also includes disclosure requirements and mandatory credit ratings by a registered rating agency for issues.

Developing the dispute resolution process for Sharia'a compliant transactions, establishing a federal level Sharia'a board and allowing primary sales of Sukuk to retail investors could further support debt market growth

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Dubai Economic Council (DEC) acts as the strategic partner for the Government of Dubai in economic policymaking. Its mission is to advise the Government of Dubai on forward looking economic strategies, to advocate sound economic policies that promote the business environment, productivity, investment climate, and to enhance Dubai's competitiveness in the world economy.

Over the last 10 years of its experience, the Council put forward several initiatives and policy recommendations that contributed significantly in enhancing the economic decision making in the emirate.

The Council is considered to be the first advisory body in the Emirate of Dubai and the UAE. Its membership includes some of the leaders of local business communities belonging to the private sector, who contribute significantly to the economic activity in Dubai, in addition to representatives of some government departments concerned. This unique combination of its membership enables the Council to employ the insights, experiences and visions of its members in a way that enhances the economic development process of Dubai.d achieve Dubai Government's vision in consolidating the business community's role in enhancing sustainable economic development process in Dubai and the UAE.

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