

# DIFC OTC FIXED INCOME SECURITIES MARKET



**A DFSA PAPER IN FINANCIAL  
MARKETS REGULATION**

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# TABLE OF CONTENTS

<b>1. EXECUTIVE SUMMARY</b>	<b>5</b>
1.1 Overview	5
1.2 Key Observations	5
<hr/>	
<b>2. DEFINITIONS</b>	<b>6</b>
<hr/>	
<b>3. PROJECT PURPOSE</b>	<b>7</b>
3.1 Overview and Context	7
3.1.1 Key factors and drivers	7
3.1.2 The Project sought information on a number of key themes	8
<hr/>	
<b>4. PROJECT STAGES</b>	<b>9</b>
4.1 Stage 1- EPRS Transaction Data	9
4.2 Stage 2 - Interview Data	9
4.3 Stage 3 - Online Survey Data	9
<hr/>	
<b>5. OBSERVATIONS</b>	<b>10</b>
5.1 Observations	10
5.1.1 Scope of operational activity in the DIFC and the UAE	10
5.1.2 There is a significant level of OTC FIS activity in the DIFC but there are risks	11
5.1.3 Project participants claim there are no significant hurdles with respect to price discovery and liquidity however some improvements can be made	12
5.1.4 The DIFC is a long term listing venue for FIS	12
5.1.5 Market-based financing is gaining prominence over Loan-based financing	13
5.1.6 Developmental considerations	13
<hr/>	
<b>6. OBSERVATIONS AND ANALYSIS</b>	<b>15</b>
6.1 Size and Scope of the FIS Market	15
Operating Model	16
6.2 Securities Issuances and Listing	18
6.3 Customers	20
6.4 Price Discovery, Transparency and Liquidity	22
6.5 Transaction Reporting	26
6.6 Clearing and Settlement	26
6.7 Transaction Activity	27
6.8 Respondents' Comments	28
6.8.1 Regulatory comments and challenges	29
6.8.2 Geopolitics and regulatory challenges	29
6.8.3 Limited market depth and liquidity	29
6.8.4 Operational impediments	31



# 1. EXECUTIVE SUMMARY

## 1.1 OVERVIEW

As part of the Dubai Financial Services Authority's (DFSA) efforts to ensure proper regulation of the trading activity in fixed income securities in the Dubai International Financial Centre (DIFC), the DFSA conducted a review of the DIFC's over-the-counter (OTC) fixed income securities (FIS)<sup>1</sup> market to better understand its structure and the level and extent of activity taking place in or from the DIFC. As part of the project, the DFSA interviewed a select group of market participants that are based in the DIFC and in the UAE broadly. The DFSA also carried out an online survey of a wider sample of DFSA regulated firms and markets participants that are based outside the DIFC.

The project revealed a number of observations, which are outlined below. While the findings are indicative of the current state of the market, the DFSA has determined that further analysis will need to be carried out to ensure the markets are operating in a fair, transparent, efficient and proper manner.

## 1.2 KEY OBSERVATIONS

a) Data obtained from the Electronic Prudential Reporting System (EPRS) found that volumes in OTC FIS transactions arranged and/or executed in or from the Centre grew substantially during the period of 1 January 2015 to 30 June 2017. Outside of the EPRS data, the DFSA does not currently mandate the submission of detailed FIS transactional data that is arranged and/or executed in or from the DIFC and might require reporting of specific transactional information in the future.

- b) In general, market participants indicated that price information for a desired FIS was neither difficult to determine or obtain.
- c) A few large Authorised Firms dominate the market which could represent pricing risk, as these Firms may have the ability to unduly influence prices of FIS sold to or bought from clients.
- d) Further, should one or two of the larger firms relocate their operation outside of the DIFC, the level of FIS transactions could potentially be impacted in the short term.
- e) FIS issued by UAE companies appear to be less liquid than comparable FIS issued by international entities because of a number of factors, which include: the relatively small amounts of FIS of UAE companies floating in the market; and the relatively low level activity by some institutional investors such as pension funds and insurance companies in the market of FIS of UAE companies. Factors that contribute to reducing market liquidity appear to make FIS of UAE companies less attractive to international investors.

<sup>1</sup> In this report, and with respect to transactions in FIS, the terms "arranged and/or executed" and "conducted" will be used interchangeably.

## 2. DEFINITIONS

**Dealer** refers to a firm that arranges and/or executes transactions in securities as an agent and/or principal on behalf of others or for its own account. The term also includes market makers and inter-dealer brokers.

**Bank** refers to a firm that offers traditional banking services such as accepting deposits and offering loans. In the context of this survey, a firm that accepts deposits and offers loans but which also executes transactions for its own accounts or on behalf of its customers would also be considered a bank.

**DIFC OTC fixed income securities markets** refer to activity in over-the-counter fixed income transactions (trades) that originate in or from the DIFC, or that are intermediated by DIFC entities, regardless of whether the transactions involve securities that appear on the DIFC Official List of Securities.

**DIFC OTC fixed income transaction** refers to an over-the-counter transaction (trade) in fixed income securities 'Executed' or 'Arranged' by an Authorised Firm on behalf of a client or on its own behalf as principal.

**Arranging fixed income transactions** means: (a) making arrangements with a view to another person, whether as a principal or an agent, buying, selling, subscribing for or underwriting a transaction; or (b) making arrangements for another person, whether as a principal or an agent, to borrow money by way of a credit facility. This includes: (a) arrangements which do not bring about the transaction; and (b) arrangements comprising or involving the receipt and transmission of client orders in relation to a transaction.

**Executing fixed income transactions** means: to carry into effect or perform the transaction, whether as a principal or as an agent, including instructing another person to execute the transaction.

**Private placement** refers to an exempt offer of securities in or from the DIFC (under MKT 2.3.1) where the securities are not admitted to the DFSA's Official List of Securities. In effect, this refers to fixed income securities being offered in or from the DIFC which is not supported by a DFSA prospectus.

**Transaction** refers to any transaction undertaken by an Authorised Firm in the course of carrying out a Financial Service in or from the DIFC.

**Asset Manager** refers to a person or company that manages someone else's assets such as money, stocks, bonds and financial instruments.

**Primary market** is where fixed income securities are created and initially sold to investors.

**Secondary market** is where investors can sell or buy bonds after their issuance at any time until their maturity or redemption.

**UAE** in this report, the UAE region excludes the DIFC; the GCC region excludes the UAE; and the MENA region excludes the GCC.

## 3. PROJECT PURPOSE

### 3.1 OVERVIEW AND CONTEXT

The FIS markets provide an important source of financing for public and private sector institutions which also provide the opportunity to diversify funding sources away from bank lending and equity capital markets.

The DFSA carried out a study of the FIS market in the DIFC to better understand the breadth and depth of the activity taking place in or from the Centre. The project also aimed to identify risks and what, if any, action might be required to provide the necessary level of protection to customers and other market participants.

The study suggests that regulatory access to timely and complete transactional information will further support the DFSA in carrying out its regulatory functions.

#### 3.1.1 KEY FACTORS AND DRIVERS

a) The EPRS data available to the DFSA clearly indicated that Authorised Firms arrange and/or execute significant activity in FIS. In addition, Bloomberg data obtained by the DFSA also indicated that GCC governments and GCC based companies issued significant amounts of FIS during the period 01/01/2012 to 30/06/2017.

International regulators have increased emphasis and focus on FIS. For example, in August 2016, the International Organisation of Securities Commissions (IOSCO) published a consultation report on the examination of liquidity in the secondary corporate bond markets<sup>2</sup>. IOSCO also has a team reviewing regulatory and market developments in reporting and transparency in the secondary corporate bond markets. The reporting and transparency review

focuses on the importance of both requirements (regulatory reporting and transparency) and the approaches taken in different jurisdictions. **Based on the information provided by IOSCO in its bond related reports, it is clear that IOSCO views public transparency and accessibility to information to be key components of robust capital markets. IOSCO also views regulatory access to robust and complete information as an essential tool that enables regulators to effectively carry out their regulatory functions.**

- b) Since most, if not all of the trading in FIS occurs OTC, and in light of IOSCO's view of public transparency and accessibility to information as key components of robust capital markets, the DFSA might require more timely and complete information on FIS transactions arranged and/or executed in or from the DIFC.
- c) The EU's Markets in Financial Instruments Directive II (MiFID II) regulation<sup>3</sup>, which is scheduled for implementation in 2018, introduces a pre and post transparency regime for bonds. The DFSA's analysis of the DIFC's OTC FIS market will support it in determining whether it should introduce transparency and reporting rules that are equivalent to MiFID II and other international standards.
- d) To create an environment where FIS are traded in a fair and transparent manner; and where market participants and customers are treated fairly. A fair and transparent environment should help accelerate the development of the DIFC and UAE debt capital markets.

<sup>2</sup> In its report titled "Examination of Liquidity of the Secondary Corporate Bond Markets" (published in August 2016), IOSCO noted that data disclosed through transparency requirements, along with relevant non-public data reported to regulators concerning corporate bond trades, can provide regulators with valuable data that can be used to create liquidity metrics. In the report, IOSCO also identified the countries which mandate transaction reporting of FIS trades. The countries noted include USA, Canada (as of November 2015), Brazil and the EU (since 2007). IOSCO also noted that there are a number of initiatives in different jurisdictions that will introduce or have introduced transparency to corporate bonds markets. IOSCO published a follow-up Media Release to this report in March 2017. In the Media Release, IOSCO indicated that the primary challenge facing IOSCO during its fact-finding work was a lack of useful data on the trading of corporate bonds on the secondary market in different jurisdictions, largely because most bonds are traded through decentralised, dealer-intermediated OTC markets. IOSCO found it particularly challenging to analyse information due to data gaps and differences in collection methods and the scope, quality and consistency of data across different jurisdictions. The study also reinforced IOSCO's view that regulators should have access to timely, accurate and detailed information on secondary bond markets to be able to assess adequately changes in these markets, monitor trends in trading, and respond accordingly.

<sup>3</sup> MiFID II, from January 2018, will require firms, large as well as small sized, make, for non-equity instruments (which include debt), public disclosure of pre-trade quotes prices and indications of interest and also to publish details of their OTC transactions in near real time (post-trade transparency). While the pre-trade transparency regime will only apply on platform, the post-trade transparency regime will encompass all transactions made either on a platform (Regulated Markets, Multilateral Trading Facilities or Organised Trading Facilities), or on OTC.

### 3.1.2 THE PROJECT SOUGHT INFORMATION ON A NUMBER OF KEY THEMES

- a) The manner by which Project participants conduct FIS transactions. For example:
- Whether Project participants arrange and/or execute FIS transactions in the primary/IPO, and/or secondary markets;
  - Whether Project participants conduct FIS transactions in principal, matched principal or agency capacity;
  - Whether Project participants arrange or execute FIS transactions through their own electronic platforms, third-party platforms (including those provided by information providers) or through traditional means.
- b) The types of FIS arranged and/or executed by the market participants (e.g. sovereign, corporate, Sukuk, or asset-backed securities).
- c) Changes in Project participants' inventory levels over the survey period.
- d) The sources and methods used by Project participants to obtain pricing information and the level of difficulty in doing so.
- e) FIS transactions data such as annual value and number of FIS transactions executed by Project participants;
- f) Assessments by Project participants as to liquidity levels of FIS issued in different regions.
- g) The level of trading activity by GCC customers in FIS.
- h) The types of customers and players active in OTC FIS markets.
- i) How FIS transactions clear and settle.
- j) The types of activities performed by market participants such as dealers, banks, asset managers, issuers, information providers and ratings agencies with respect to OTC FIS.
- k) Any regulatory and/or business concerns for Project participants with respect to the development of FIS markets in the DIFC and UAE.

## 4. PROJECT STAGES

This Project was conducted in a number of stages:

### 4.1 STAGE 1- EPRS TRANSACTION DATA

The DFSA reviewed and analysed the EPRS data reported to the DFSA with respect to FIS transactions activity in the DIFC for the two and a half year period ending 30 June 2017. The analysis was conducted to understand the level of FIS transactional activity in the DIFC and to identify the relevant market participants to include in its interviews and online survey. The EPRS data is reported to the DFSA on a quarterly basis and represents transaction activity arranged and/or executed by Authorised Firms in or from the DIFC.

### 4.2 STAGE 2 - INTERVIEW DATA

The DFSA then conducted interviews with a select group of Project participants. During the interview phase of the Project, the DFSA interviewed 16 market participants, 13 of which were located in the DIFC with the remaining three located in the UAE (outside the DIFC). The 16 market participants interviewed included eight dealers, one issuer, two credit ratings agencies and two asset managers (in the DIFC), and three Dealer/Banks located in the UAE (outside the DIFC).

Interviews were semi-structured (a document which outlined key discussion themes was provided to the firm in advance) and were kept deliberately flexible to allow participants to focus on issues or topics that were of most concern or relevance to them. Interviews mostly lasted around 45 minutes to one hour and were conducted in person. The interviewees all had particular expertise in the FIS markets.

### 4.3 STAGE 3 - ONLINE SURVEY DATA

In addition to the EPRS data and the interviews conducted, the DFSA also conducted an online survey of active market participants in OTC FIS<sup>4</sup>. The online survey was sent to Authorised Firms (i.e. banks, dealers, asset managers), issuers, other market participants (i.e. credit ratings agencies, information providers and exchanges), and a select number of participants from outside the DIFC. In total, 30 responses were received from dealers/banks (two of whom indicated that they were also issuers), 11 responses were received from asset managers, and 11 were received from information providers, exchanges, credit ratings agencies and other market participants. All dealers/banks, asset managers and issuers that responded to the online survey were DFSA-regulated entities while the 30 dealers/banks that responded represented approximately 95% of the OTC transaction activity in or from the DIFC for 2015 and 2016.

<sup>4</sup> The online survey was sent to all DIFC Authorised Firms, DIFC issuers, information providers in the DIFC and certain select UAE dealers/banks: 75 firms responded, of which 96% were regulated by the DFSA. 73.3% of the respondents were DIFC companies and 26.7% were non-DIFC companies. Thirty (30) respondents fell in the dealer/bank category, 11 respondents fell in the asset managers category, 11 respondents fell in the information providers category, rating agency, exchange and other market participant category, and 23 respondents fell in the "none of the above" category. Please see the "Findings/Results" section below for more information. Two of the dealers/banks respondent also indicated that they issued FIS.

# 5. OBSERVATIONS

## 5.1 OBSERVATIONS

The sections below lists a summary of the key observations noted by the DFSA during the Project. The observations are based on the information obtained from: the DFSA's internal systems (i.e. the EPRS and Primary Market data), third-party data providers, interviews with market participants and an online survey.

### 5.1.1 SCOPE OF OPERATIONAL ACTIVITY IN THE DIFC AND THE UAE

#### Activity levels dealer/banks, asset managers and onshore UAE banks

- a) Dealer/bank respondents are quite active in conducting FIS transactions. For the most part, the responses from this group provided the best insight into the transactional nature of the FIS activity in the DIFC.
- b) Only a small number of DIFC-based dealers/banks interviewed, operate an 'arranging-only' model where all FIS transaction orders are routed to overseas offices for execution and clearing. These dealers/banks are essentially acting as regional hubs in order to gain proximity to clients.
- c) Interviews with banks based in the UAE revealed that these banks provide a complete set of FIS-related services including: underwriting, purchasing and selling on behalf of customers and trading on a proprietary basis for the banks' own trading accounts, as well as for the banks' investment accounts. Investment advisors associated with UAE banks also buy and sell FIS and provide FIS-related research.
- d) The online survey revealed that the scope of FIS activities performed by DIFC firms is wide and not limited to being a sales function.

- e) Dealer/bank respondents are fairly active in the fixed income space. Around 43% of the respondents conduct FIS transactions worth more than USD 1 billion (face/par value) and more than 1,000 FIS transactions each, annually.
- f) More than half of the asset manager respondents bought and sold FIS through third party dealers.
- g) Activity levels among almost all asset manager respondents (91%) were low with on average each only conducting up to USD 100 million worth of FIS transactions a year.

#### Executing vs arranging; principal vs agency; primary vs secondary; and inventory levels

- h) The majority of dealers/banks interviewed perform most of the actions taken by market participants during the normal course of executing a FIS transaction. In other words, upon receiving a FIS transaction order or request from a customer; most of the dealers/banks start working on the customer order/request by: researching the FIS; contacting other market participants to locate and price the FIS subject to the order/request; conducting the necessary market research to determine the fair price of the FIS; and confirming the details and specifics of the order/transaction with the customer prior to executing the order. After the terms of the FIS have been determined and agreed by all market participants, some of the dealers/banks interviewed said that they execute and book the FIS transaction in the DIFC while others route the order to their head offices for execution and booking. The FIS transactions can be arranged and/or executed either on an agency, principal or matched principal basis.

The online survey responses appear to confirm the corresponding information provided to the DFSA during the interviews.

- i) Around half of the dealer/bank online survey respondents conduct FIS transactions on a principal or matched principal basis for their own accounts.
- j) Around a third of the dealer/bank respondents maintain inventories of FIS and 80% of those indicated that the average daily face/par value of inventories held by them has increased or remained unchanged over the last three years.
- k) Of the dealer/bank respondents, 80% said that they arrange and/or execute FIS transactions in the primary market while 97% arrange and/or execute FIS transactions in the secondary market.

#### Booking: DIFC vs abroad, clearing and settlement

- l) Based on the online survey, about 63% of the dealer/bank respondents execute<sup>5</sup> FIS transactions and about 56% of dealer/bank respondents booked their FIS transactions in the DIFC.
- m) Based on the interviews conducted, it appears that FIS transactions (whether UAE/DIFC or internationally issued FIS) are cleared and settled through Euroclear and Clearstream. Accordingly, at this moment (and unless there is a mandate to clear UAE and/or DIFC issued FIS), there is no incentive to clear and settle FIS transactions that are arranged or executed in the DIFC or UAE via a DIFC or UAE central-counterparty (CCP). Currently, the DFSA does not identify any significant risks or regulatory needs to mandate clearing and settling of FIS transactions through a DIFC or UAE-based CCP.

#### Diverse choices of FIS offered and active UAE/DIFC customer base

- n) Dealer/bank respondents do not limit their arranging and executing activity to those FIS that are issued in a specific country or region.

- o) Of the dealer/bank respondents, 81% arrange and/or execute FIS transactions on behalf of customers that are located in the DIFC, around 89% of respondents arrange and/or execute FIS transactions on behalf of customers located in the UAE (excluding the DIFC) and around 85% of the respondents arrange and/or execute their FIS transactions on behalf of GCC customers (excluding the DIFC). Some firms noted that the level of participation and sophistication of customers and market participants in the FIS market in the DIFC has increased.

### 5.1.2 THERE IS A SIGNIFICANT LEVEL OF OTC FIS ACTIVITY IN THE DIFC BUT THERE ARE RISKS

- a) The data obtained from the EPRS revealed that a significant number of OTC transactions in FIS were arranged and/or executed by Authorised Firms in or from the DIFC.
- b) For the two and a half year period ending 30 June 2017, 51 Authorised Firms conducted a total of 400,000 FIS transactions representing a total transaction value of USD 1.9 trillion (USD 901 billion, USD 667 billion and USD 357 billion for 2015, 2016 and the half year ending June 30 2017, respectively). This represents an average quarterly transaction value of approximately USD 190 billion. Much of that activity is dominated by a few large Authorised Firms with six banks representing 82% of the total value of FIS transactions, which could represent pricing risk. The DFSA notes that timely and complete transactional data reporting to the DFSA could reduce this risk.
- c) From a liquidity risk perspective, should one or two of the large Authorised Firms decide to move their fixed income operations elsewhere; the level of FIS transaction activity in the DIFC could potentially be impacted in the short term. However, interview respondents noted that these major participants have been losing market share to other firms that have been increasing their fixed income operations, signalling a maturing market.

<sup>5</sup> Execute FIS was defined as: A firm that carries into effect or performs the FIS transaction, whether as principal or as agent, including instructing another person to execute the transaction.

d) Based on information from third-party data providers, the value of FIS issued in the GCC<sup>6</sup> region during the five year period between 01/01/2012 and 31/12/2016 was significant and worth about USD 1.07 trillion. Of the USD 1.07 trillion, USD 963.5 billion were issued by governments and USD 107.1 billion were issued by corporates.

e) Project participants indicated that the success and sustainability of any FIS market depends on several important factors which include:

- The number and size of FIS issuances by UAE companies;
- The number and size of FIS issuances by local governments, which also helps in establishing a reference yield curve and obtaining credit ratings of the issuers and issuances to expand the pool of international investors that can buy the UAE/DIFC issued FIS;
- The active participation in the market by UAE investors given international investors always look at the trading patterns of the UAE market investors before making significant investments in the UAE market (international investors buy FIS of companies and issuers that are favoured by UAE investors);
- The range of maturities of the FIS issued by UAE companies (in general UAE investors prefer shorter maturities of FIS, while international investors prefer longer term maturities); and
- Fair and transparent FIS markets.

### 5.1.3 PROJECT PARTICIPANTS CLAIM THERE ARE NO SIGNIFICANT HURDLES WITH RESPECT TO PRICE DISCOVERY AND LIQUIDITY HOWEVER SOME IMPROVEMENTS CAN BE MADE

a) In general, Project participants claimed that they do not face significant hurdles with respect to price discovery and liquidity in determining or obtaining price information for the desired FIS. Third-party data providers and dealers in FIS are the two main sources for obtaining pricing information, with the dealers

playing a more significant role for FIS that are illiquid. Project participants also benchmark against comparative yield curves to obtain pricing information. Timely and complete transactional FIS data reports to the DFSA would contribute to improving price transparency.

- b) In general the Project participants interviewed, indicated that the level of liquidity in FIS is acceptable. However, several participants commented that generally they have experienced a reduction in FIS liquidity. They indicated for example, that newly issued bonds are traded heavily in the first week of trading with trading activity then settling until some form of credit event or liquidity event occurs.
- c) It appears that FIS that are issued by UAE companies are less liquid than some of the foreign issued FIS due to factors that are specific to the UAE markets, which are discussed in detail under the “Challenges and Impediment to Growth” section below.

### 5.1.4 THE DIFC IS A LONG TERM LISTING VENUE FOR FIS

a) The DIFC continues to be a leading regional listing venue for conventional bonds and Sukuk. Over the last five years, the number of FIS listings has increased from two listings (USD 1.15 billion) in 2012 to a total of 84 listings (USD 53 billion) in 2016. However, Project participants do not attach significant importance to the actual location of the listing venue for FIS. For example, it makes little difference to the issuer or its advisers as to whether its FIS is listed in the DIFC, the UK or Ireland (other successful listing jurisdictions for FIS).

According to the Project participants, the reasons for the DIFC’s success as a regional listing venue for FIS include: the DFSA’s regulations, review processes and procedures being aligned to international standards, the continued support from the Dubai Government, a recent growth in Sukuk listings and the recognition that NASDAQ Dubai is becoming an important venue for Sukuk products and the market development efforts of NASDAQ Dubai.

### 5.1.5 MARKET-BASED FINANCING IS GAINING PROMINENCE OVER LOAN-BASED FINANCING

- a) According to the Project participants, prior to the recent economic slowdown, UAE companies and governments did not face any significant hurdles to securing bank financing and loans. As a result, UAE companies and governments had no pressing incentives to issue FIS to raise the funds to finance their business activities and funding needs. However, due to the recent reduction in oil prices and the resulting economic impact on banks, UAE companies and governments have started raising the needed funds through the capital markets by issuing FIS, for example. Project participants also indicated that market-based financing is expected to grow in the coming years with the expected continuation of low oil prices.
- b) With respect to the primary markets, the information obtained by the DFSA through the interviews, indicated that a few banks dominate the underwriting of FIS issued by UAE companies. The UAE issuers of FIS tend to issue the securities in both local and foreign currency. The FIS issuance data obtained by the DFSA through third-party data providers supported the interview findings and indicated that most of the FIS issued by GCC issuers (during the period of 1/1/2012 to 31/12/2016) were issued in foreign currency denominations.

### 5.1.6 DEVELOPMENTAL CONSIDERATIONS

The interviews and online survey raised a number of concerns that could pose risks to and may impede the development of FIS markets in the UAE and by association, the DIFC.

These are as follows:

#### **A few banks dominate the FIS underwriting market and customer tendencies**

- a) Underwriting FIS of UAE companies is dominated by a few banks that tend to also buy and hold most of these securities for their own accounts. This practice has led to a reduction of FIS floating in the market and in turn, may reduce the appeal of UAE-issued FIS for international investors. Timely and complete transactional FIS data reported to the DFSA would assist in verifying whether clients are receiving fair and reasonable prices. Some interviewees indicated that imposing concentration haircut/capital charges on the banks that underwrite and hold large percentages of the FIS they underwrite may help increase the liquidity and depth of the market for FIS of UAE companies.
- b) In addition to the above, UAE investors generally tend to hold FIS to maturity which depresses liquidity further.
- c) Due to strong demand by underwriters and banks in the past, some companies/issuers may not have been incentivised to rate their FIS securities. However, by obtaining a credit rating, these issuers can potentially open up their pool of investors to include international institutional clients whose investments mandates require them to buy only highly-rated securities.

<sup>6</sup> The GCC FIS issuances comprising the USD1.07 trillion were not all in USD but were rather in combinations of various currencies including Euros, Japanese Yens, Swiss Francs, GCC currencies, Singaporean Dollars etc.

**Increasing the depth of UAE markets**

- d) The depth and breadth of the UAE and regional investor base could be enhanced by allowing institutional investors such as pension funds and insurance companies to invest in the securities or derivatives markets. This may significantly improve the depth and diversification of the investor base and FIS market.
- e) Depth and liquidity of the FIS market can be improved through increased sovereign issuances which could help to establish a yield curve. The market could also benefit from an increase in FIS programme issuances.

**Geopolitics and regulatory challenges**

- f) There is some apprehension of geo-political risks in the GCC.
- g) The respondents' perception is that the GCC and UAE markets would benefit greatly from having regulatory frameworks that are aligned with one another and international standards. Passporting arrangements would also support further growth of the market.

- h) Market participants also indicated that improved coordination between local and regional regulators could encourage more market activity, which would increase transactional volumes and liquidity.

**Operational challenges**

- i) Enhancements can be made to operations, accounting, custody and settlement processes such as:
  - Improving back office operations and ensuring proper staffing, and
  - Streamlining and enhancing the custody regime, settlement cycle and accounting structure.

# 6. OBSERVATIONS AND ANALYSIS

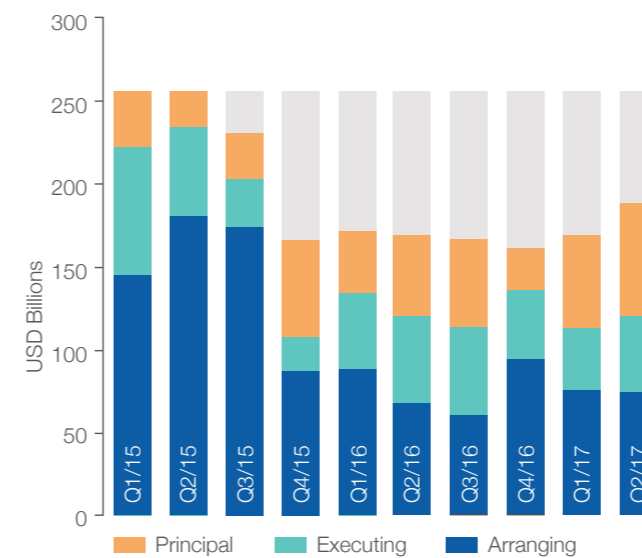
## 6.1 SIZE AND SCOPE OF THE FIS MARKET

### A. LEVEL OF ACTIVITY IN THE FIS MARKET

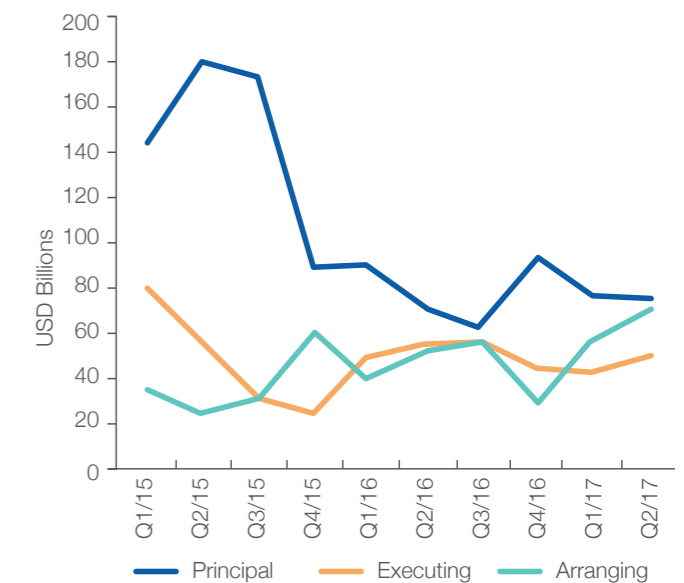
Based on the EPRS data received for the two and a half year period ending 30 June 2017 as illustrated in Figures 1 and 2, 51 Authorised Firms conducted a total of 400,000 fixed income transactions representing a total transaction value of USD 1.9

trillion, of which, USD 901 billion were conducted in 2015, USD 667 billion were conducted in 2016 and USD 357 billion were conducted in the half year ending June 30, 2017. This represents an average quarterly transaction value of approximately USD 190 billion.

**Figure 1:**  
DIFC Fixed Income Transaction Activity



**Figure 2:**  
DIFC Fixed Income Transaction Activity by Value





## OPERATING MODEL

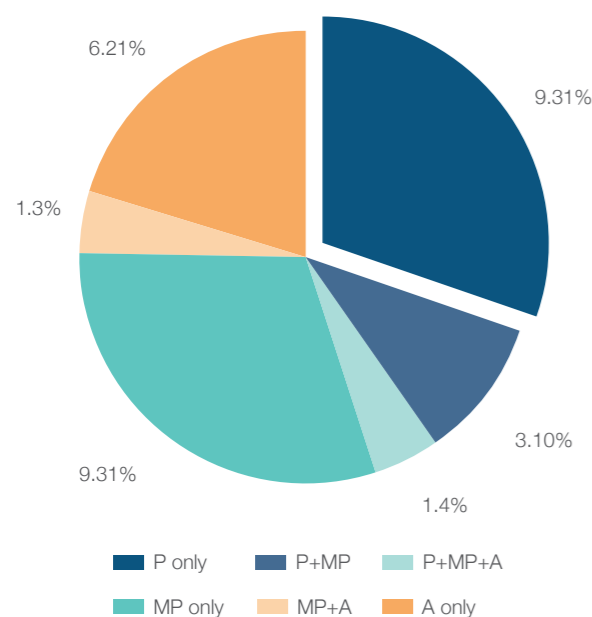
### A. OPERATING MODEL

Information regarding the operating models of the respondents obtained through the interview process appear to be in line with the information obtained through the online survey.

#### Survey findings

- About 30% of dealer/bank respondents<sup>7</sup> conduct FIS transactions **only** on principal (“P”) basis for their own account, 30% conduct FIS transactions **only** on a matched principal (“MP”) basis, 20% conduct FIS transaction **only** on an agency (“A”) basis, 10% conduct FIS transactions on a principal and matched principal basis, and 3.3% conduct FIS transactions on a principal and agency basis. Considering dealer/banks respondents that operate under more than one capacity, 46.7% of the dealer/bank respondents conduct FIS transactions on a principal basis for their own accounts, 46.7% conduct FIS transactions on a matched principal basis and 30% conduct FIS transactions on an agency basis. Please see Figure 3 for more information;

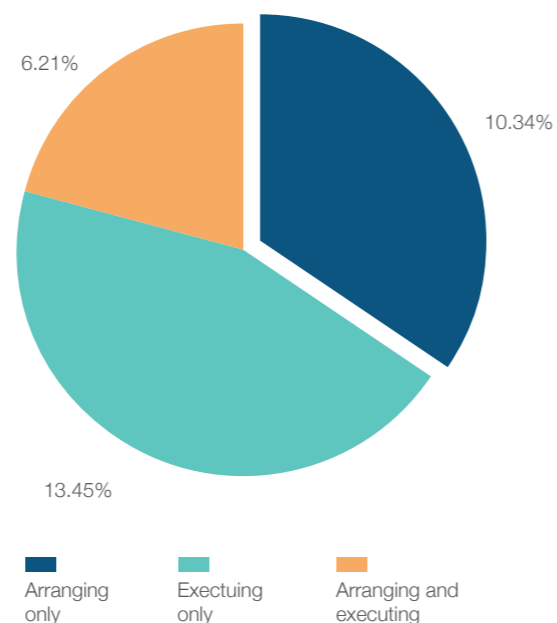
**Figure 3:**  
Operating Capacity (Dealers/Banks)



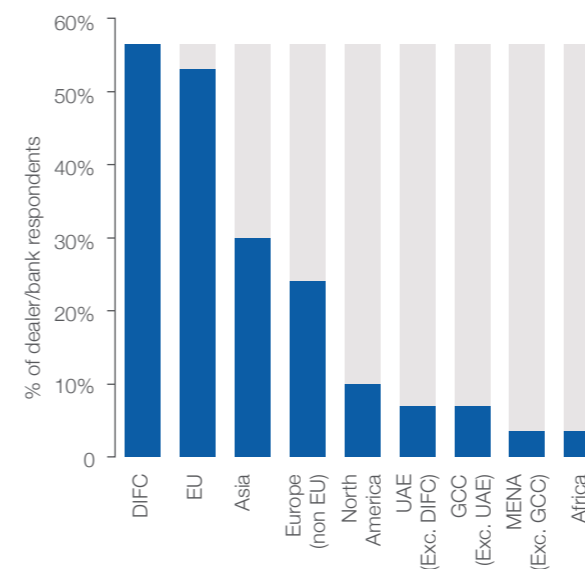
- Figure 4 shows that about 40% of dealer/bank respondents **only** execute FIS transactions, 30% **only** arrange FIS transactions, 20% execute **and** arrange FIS transactions, and 3.3% conduct FIS business via “Other”. Considering dealer/bank respondents that execute as well as arrange FIS business, 63.3% of the dealer/bank respondents execute FIS transactions and 53.3% arrange FIS transactions;

- Figure 5 shows that most dealer/bank respondents have more than one booking location. Top booking locations include the DIFC, EU, Asia and Europe ex-EU. Specifically, around 56% of the dealer/bank respondents booked their FIS transactions in the DIFC and 53% booked their FIS transactions in the EU. In addition, among the firms that do not hold FIS inventories, 60% booked their FIS transactions in the DIFC, while 50% booked their FIS transactions outside the DIFC. The fact that 56% of the dealer/bank respondents booked their FIS transactions in the DIFC was an unexpected outcome and goes against the prevailing assumption that DIFC Authorised Firms do not book their transactions in the DIFC. These responses reflect the maturity of firms’ operations

**Figure 4:**  
Arranging vs Execution (Dealers/Banks)



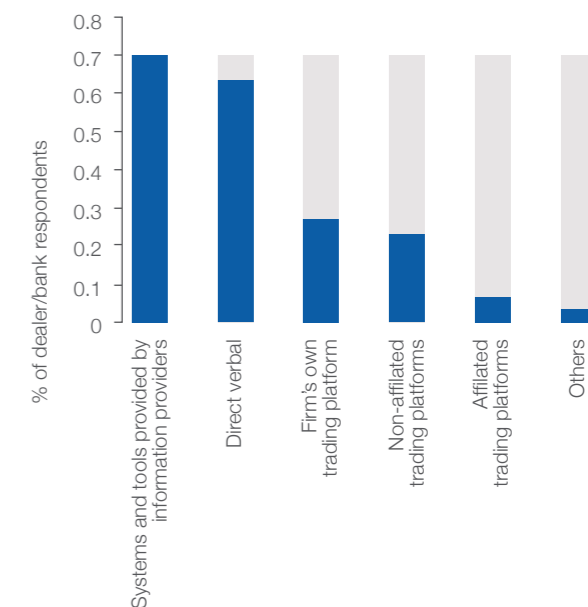
**Figure 5:**  
Booking Locations (Dealers/Banks)



in the DIFC and long term nature of authorised firm’s plans and operations in the DIFC;

- Figure 6 revealed that 70% of the dealer/bank respondents relied on “using the systems and tools provided by information providers” (e.g. Bloomberg) as the principal communications mediums for conducting FIS transactions and about 63% relied on “direct verbal communications” with counterparties. The online survey data also revealed that nine (30%) of respondents solely utilised “direct verbal communications” and the “systems and tools provided by information providers” to execute FIS transactions. The use of electronic trading platforms to execute FIS transactions was not as widespread with 23.3% of dealer/bank respondents using non-affiliated third-

**Figure 6:**  
Communication (Dealers/Banks)



party electronic platforms to execute FIS transactions and 26.7% using their own electronic trading platforms. The use of electronic trading platforms to execute FIS transactions seems to be in-line with the international practices as market participants are becoming increasingly accustomed to utilising electronic trading platforms to execute FIS transactions;

- Figure 7 shows that 33.33% of the dealer/bank respondents indicated they maintained FIS inventory and 66.67% indicated they do not maintain inventories. Of those that maintain inventories, 50% of the dealer/bank respondents indicated that their average daily face/par value of the inventory held by them has increased, 30% remained unchanged and 20% decreased over the last three years;

<sup>7</sup> Based on responses by 30 dealer/bank respondents.

- With respect to asset managers, about 55.5% of asset manager respondents bought and sold sovereign bonds/Sukuk and corporate bonds/debentures (including government related entities). Of the asset manager respondents, 45.5% bought and sold supranational bonds or Sukuk, and 18.1% bought and sold asset backed securities; and
- In addition, 18.1% of asset manager respondents bought and sold FIS through affiliated dealers, 54.5% bought FIS through third-party dealers.

#### Interview findings

- The majority of dealer/banks interviewed perform most of the actions that are taken by market participants during the normal course of executing a FIS transaction. In other words, most of the dealer/banks, upon receiving a FIS transaction order or request from a customer, start working on the customer order/request by: researching the FIS; contacting other market participants to locate and price the FIS subject to the order/request; conducting the necessary market research to determine the fair price of the FIS; and confirm the details and specifics of the order/transaction with the customer prior to executing the order. After the terms of the FIS have been determined and agreed upon by all market participants, some of the dealer/banks interviewed will execute and book the FIS transaction locally, while others will route the order to its home office for execution and booking. The FIS transactions can be arranged and/or executed either on an agency, principal, or matched principal basis;
- A small number of the dealer/banks interviewed and which are located in the DIFC (AF) operate an 'arranging only' model where FIS transaction orders are routed to their overseas offices for execution and clearing. Essentially, acting as regional hubs in order to gain proximity to clients;

- How the dealer/banks conduct their FIS business in the DIFC and whether or not they book their FIS transactions in or out of the DIFC, depends greatly on the overall cost structure of the dealer and whether it is more advantageous and cheaper for them to run full FIS operations from the DIFC. It is also important to note that certain large Dealer/Bank interviewees are consolidating certain business lines across the globe, which also influences the types of activities they conduct in or from the DIFC, including operational and business decisions; and
- With respect to the UAE banks that were interviewed by the DFSA, the interviews revealed that these UAE banks provide a complete set of FIS related services which include, underwriting FIS, purchasing and selling FIS on behalf of customers, trading FIS on a proprietary basis for the banks' own trading accounts as well as for the banks' investment accounts, buying and selling FIS by the investment management companies that are managed by advisers associated with the UAE banks and providing FIS related research.

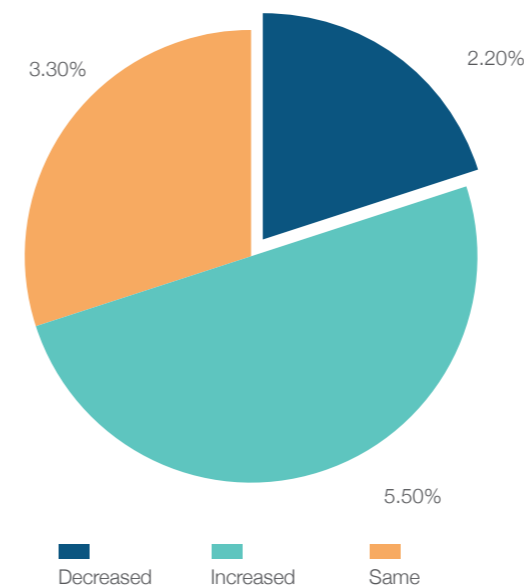
## 6.2 SECURITIES ISSUANCES AND LISTING

### A. FIS ISSUANCE AND LISTING

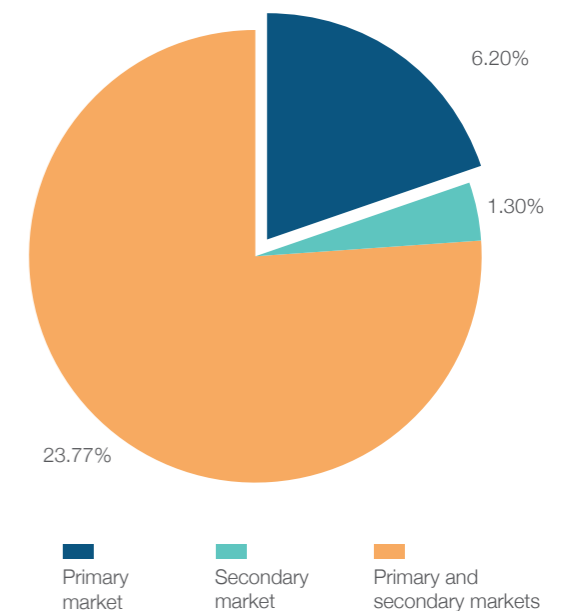
#### Survey findings

- Of the companies that responded to the online survey, only two indicated they issue FIS. One issuer indicated it is also a dealer and the other issuer indicated it is both a dealer and a bank. One of the issuers is a publicly held corporation and the other is a privately held corporation;
- Both companies indicated that they have issued FIS which are listed and/or publicly traded and also issued FIS which were privately placed. Both companies also indicated that they have only issued corporate bonds and debentures;

**Figure 7:**  
Inventory Levels (Dealers/Banks)



**Figure 8:**  
Types of Issuance (Dealers/Banks)



- Both companies issued their FIS in the EU and one issued its FIS in Asia. Also, both respondents indicated that UAE, GCC, EU and Asian customers bought their FIS during the initial public offering phase and only one issuer respondent indicated that DIFC, MENA and European non-EU customers bought their FIS during the IPO phase. The responses seem to indicate that DIFC, UAE, and GCC customers are active participants in the FIS market; and
- With respect to the markets' participants activities in the primary and secondary markets, the online survey revealed that 80% of the dealer/bank respondents arrange and/or execute FIS transactions in the primary market and 97% arrange and/or execute FIS transactions in the secondary market. This can be taken to mean that Dealer/Bank respondents are active in both the primary and secondary FIS markets and that FIS are securities that are in demand. Please see Figure 8 for more information.

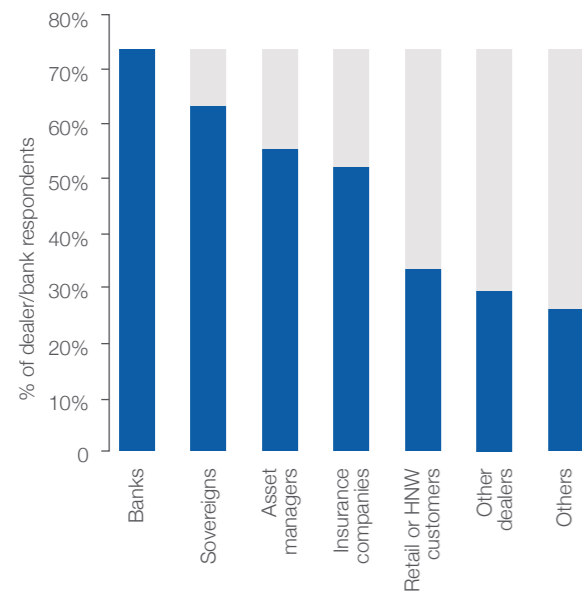
#### Interview findings

- Dealers, banks and asset managers actively participate in the primary and secondary markets and a few firms occasionally purchase privately placed FIS;

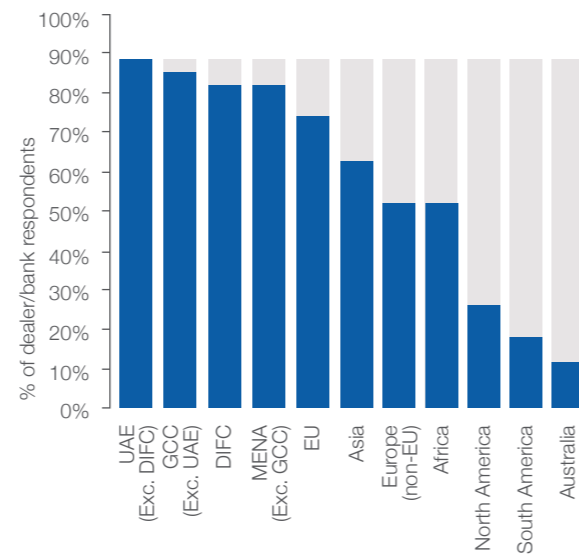
The DIFC continues its success as a leading regional listing venue for bonds and Sukuk. The reasons for the DIFC's existing listings success as a regional venue include: the DFSA's regulations, review processes and procedures are aligned to international standards, the continued support from the Dubai Government, a recent growth in Sukuk listings and the recognition that NASDAQ Dubai is becoming an important venue for Sukuk products and the market development efforts of NASDAQ Dubai;

- The dealer/bank participants interviewed commented that the location of the listing venue is not an important consideration in the overall

**Figure 9:**  
Customer Type<sup>8</sup> (Dealers/Banks)



**Figure 10:**  
Customer Locations<sup>9</sup> (Dealers/Banks)



international offering and listing process. There was some recognition of the fact that a listing provides investors with important primary and secondary market information and that the DFSA listing regime has become ‘standardised and institutionalised’. The requirement for securities to be listed is normally found in investors’ investment mandates. Some of the key factors in choosing a listing venue location include the international standing and reputation of the jurisdiction’s regulator, and speed of the prospectus review process; and

- Other market participants interviewed, indicated that underwriting of FIS of UAE companies is dominated by a few banks – which buy and hold for their own accounts – most of the FIS underwritten by them.

## 6.3 CUSTOMERS

### A. CUSTOMER TYPES, LOCATIONS, AND BUSINESS ACTIVITIES

Information regarding the customer types, locations and business activities obtained through the interview process appears to be in line with the information obtained through the online survey.

#### Survey findings

- Only 26.7% of the dealer/bank respondents indicated they offer their customers the ability to buy and sell FIS through an electronic platform. The responses provided are in line with the nature of the FIS business activity (especially in the region), as FIS do not have the liquidity or depth of market that would make electronic platforms or direct online trading by customers the most effective methods for buying and selling FIS;

- Figure 9 shows a diverse dealer/bank customer base across all categories. For example, the survey revealed that 33.3% of the dealer/bank respondents arrange and/or execute FIS on behalf of retail or high net worth customers; 74% arrange and/or execute FIS transactions on behalf of Banks; 55.6% arrange and/or execute on behalf of asset managers, 51.9% arrange and/or execute on behalf of insurance companies, and 63% arrange and/or execute on behalf of governments and sovereign funds;
- Figure 10 shows that 81% of the dealer/bank respondents arrange and/or execute FIS transactions on behalf of customers that are located in the DIFC and about 89% of the respondents arrange and/or execute FIS transactions on behalf of customers located in the UAE excluding the DIFC. In addition, 81.5%, 74%, 51.9%, 63%, and 26% of the dealer/bank respondents arrange and/or execute FIS transactions for MENA (excluding GCC), EU, non-EU European countries, Asian, and North American customers, respectively. The responses provided clearly indicate that the dealer/bank respondents have made concerted efforts to have a large base of UAE and regional customers, which is a step towards further developing liquidity and depth in the FIS market;
- UAE and regional (i.e. DIFC, UAE, GCC, and MENA) customers generated about 62% of the FIS transactions arranged and/or executed by the dealer/bank respondents. Specifically, 16.6% of FIS transactions were conducted on behalf of DIFC customers, 25.1% were conducted on behalf of UAE customers, 13.9% were conducted on behalf of GCC (ex-UAE) customers and 6.6% were conducted on behalf of MENA (ex-GCC) customers; and
- More than 40% of the dealer/bank respondents indicated that GCC customers appear to prefer (where GCC customers activity has been rated

as either medium or high) buying and selling FIS securities that are registered/approved in the UAE, GCC and the EU. Similarly, between 40% and 50% of the dealer/bank respondents indicated that non-GCC customers appear to prefer (where non-GCC customers activity has been rated as either medium or high) buying and selling FIS securities that are registered/approved in the EU and Asia.

#### Interview findings

- DIFC Authorised Firms interviewed, indicated that their customers include (1) central banks and sovereign wealth funds whose investment mandate tends to be focused on high quality, investment grade securities and where the primary mandate is safety and diversification (outside of MENA region) rather than an investment return; (2) banks and other institutional investors whose investment mandate is primarily focused on investment grade bonds (80%/90% regional); (3) high net worth individuals whose primary investment mandate is focused on yield and less on the investment grade rating. They have no retail clients. The Project participants outside the DIFC cater to a larger population of audiences which may also include retail investors; and
- The three UAE based banks interviewed seem to have a wider scope of FIS activities as these three banks issue FIS, actively participate in underwriting FIS including for UAE based issuers, purchase and sell FIS for their own proprietary accounts and execute customer FIS orders. Though no FIS activity data was provided by the two UAE based banks, it appears, based on the discussions with the banks’ representatives, that both banks are quite active in nearly all facets of the FIS markets.

<sup>8</sup>. Based on responses by 27 dealer/bank respondents  
<sup>9</sup>. Based on responses by 27 dealer/bank respondents

## 6.4 PRICE DISCOVERY, TRANSPARENCY AND LIQUIDITY

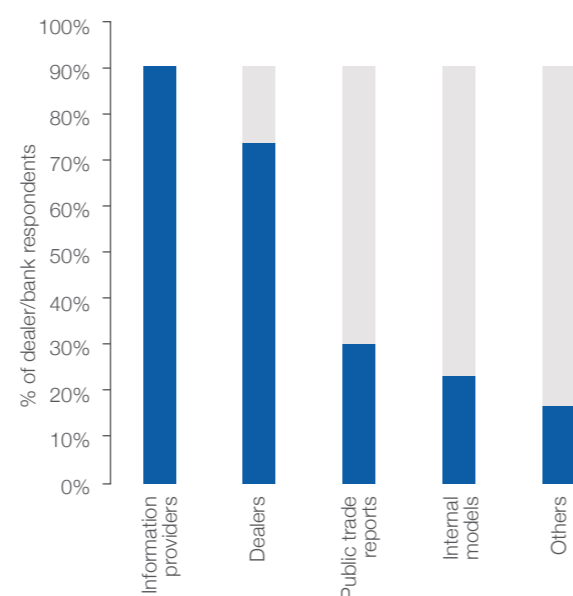
### A. PRICE DISCOVERY AND TRANSPARENCY

From the responses to the online survey and interviews, it appears that market participants can obtain price information relatively easily. Information providers and contacts with other market participants are the main sources of pricing information in the market. Most firms commented that there are no issues or challenges regarding price formation and transparency in the primary or secondary markets. That said, the general consensus seems to indicate that requiring FIS transactions to be reported for regulatory purposes and dissemination to the public (subject to certain provisions in order not to move the market) will aid in improving price transparency for all market participants and will probably result in reduced pricing spreads.

#### Survey findings

- Figure 11 shows that with respect to price discovery by dealer/banks, 90% of dealer/bank respondents utilise information Providers, 73.3% utilise other dealers, 23.3% utilise their own internal models and 30% use data from public trade reports as tools to assist them in the price discovery efforts. The DFSA notes that one dealer/bank respondent said it **only** uses dealers for price discovery and four dealer/bank respondents said they **only** use information providers for price discovery. The remaining dealer/bank respondents use multiple sources for price discovery.
- With respect to price discovery for asset managers, 63.6% of the asset manager respondents utilise information providers, 54.5% utilise other dealers, 9% utilise data from public trade reports and 36.4% use 'other' as tools to assist them in the price discovery efforts. The DFSA noted that 9% of the asset manager respondents only use information providers for price discovery and that 54.5% of the asset

**Figure 11:**  
Price Discovery Sources (Dealers/Banks)



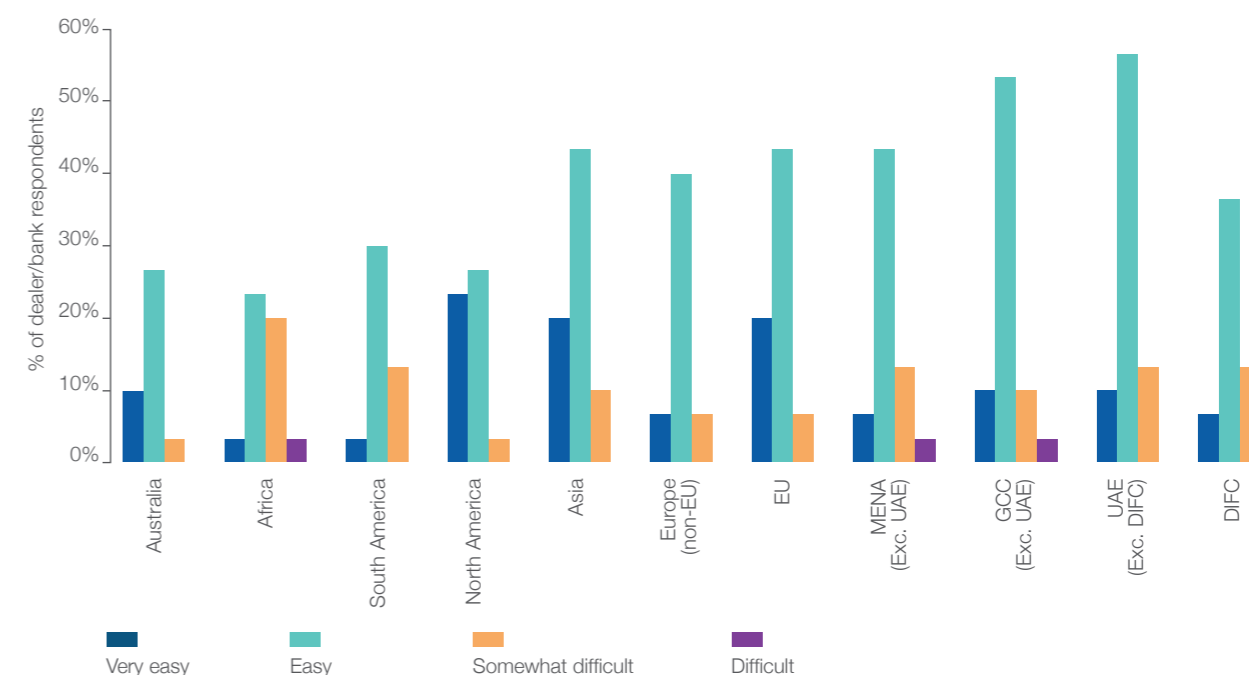
manager respondents utilise both information providers and dealers in the price discovery process; and

- Figure 12 shows that 50% or more of the dealer/bank respondents indicated that it was easy or very easy for them to obtain reliable pricing information for FIS that were issued in the UAE, GCC, MENA, EU, Asia and North America. For asset managers, more than 70% of the asset manager respondents did not provide an opinion as to the level of effort required by them to obtain reliable pricing information. The remaining 30% of the asset manager respondents indicated that obtaining reliable pricing information was either somewhat difficult, easy or very easy.

#### Interview findings

- Most of the entities interviewed access price information through dealer relationships and/or information providers. The entities interviewed also

**Figure 12:**  
Ease of Price Discovery by Jurisdiction (Dealers/Banks)



indicated that there are no issues or challenges regarding price formation and transparency in the primary or secondary markets. The entities interviewed also indicated that the pricing formation process may also involve a combination of benchmarking against comparative yield curves, access to specialised dealer/bank facilities and online trading venues. The interviewees also indicated that for non-liquid bonds they would engage dealers/banks that specialise in FIS; and

- The majority of entities interviewed but especially asset managers, credit rating agencies and issuers indicated that requiring FIS transactions to be reported for regulatory purposes and disseminated to the public (subject to certain provisions in order not to move the market) should aid in improving price transparency for all market participants and should result in reduced pricing spreads and better executions. The key for asset managers however, is the timing and content of the disseminated trade information. The asset managers interviewed

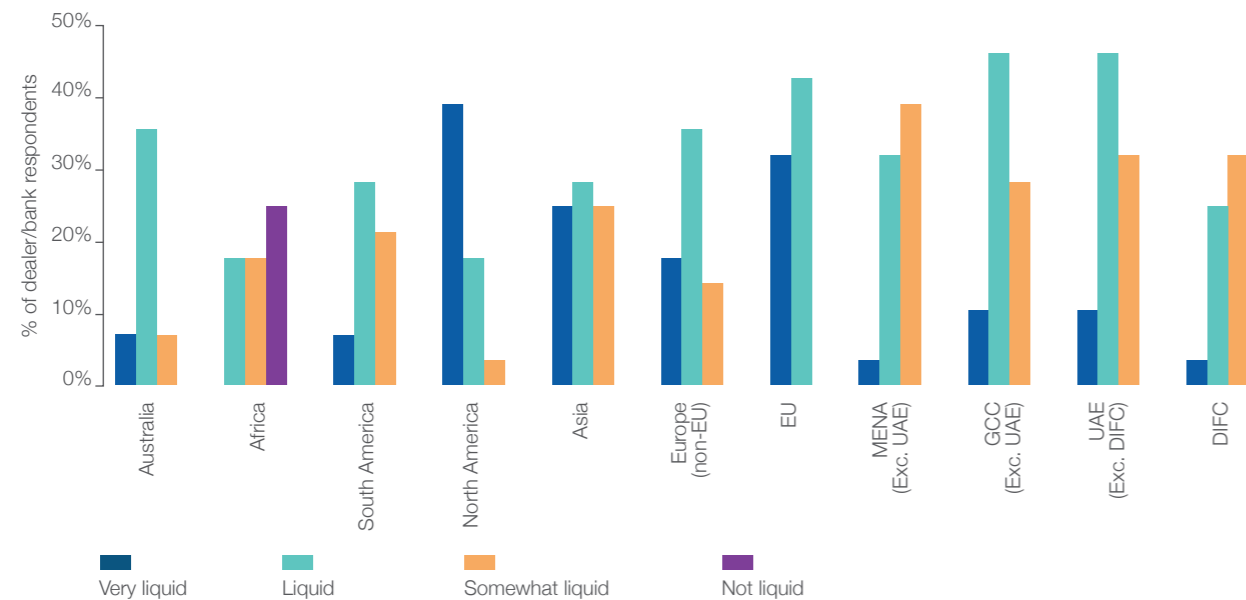
indicated that trade dissemination should be conducted in a manner that would not allow market participants and competitors to gain knowledge of the trading goals, intentions or strategy of asset managers, as such knowledge would adversely affect the strategy of asset managers and their clients.

### B. LIQUIDITY

#### Survey findings

From the responses to the online survey and interviews, it appears that the level of liquidity in the trading of OTC fixed income securities is relatively good. However, several of the entities interviewed commented that they have seen a reduction in general liquidity in the FIS market. The entities interviewed indicated that it appears that newly issued bonds are traded heavily in the first week of trading and then trading settles until there is some form of credit event or liquidity event. Please see Figure 13 for more information.

**Figure 13:**  
Price Liquidity by Jurisdiction (Dealers/Banks)



- 50% or more of the dealer/bank respondents indicated that FIS issued in the UAE, GCC, EU, Europe non-EU countries, Asia, and North America were either liquid or very liquid. Only 26.7% of the dealer/bank respondents indicated that FIS issued in the DIFC were liquid or very liquid;
- In contrast to the responses provided by the dealer/bank respondents, only 30% or more of the asset manager respondents indicated that FIS issued in the EU countries are liquid or very liquid. That said, on average; around 80% of asset managers respondents did not rate (by entering a "Not Applicable" answer) the liquidity of the FIS issued under the 11 regions that were identified for them in the online survey; and
- In addition to the dealer/bank respondents and the asset manager respondents, other market participants (e.g. credit rating agencies, exchanges and information providers) were asked to rate the liquidity of FIS issued in the DIFC, UAE, GCC and

MENA. The online survey data showed that 50% or more of the other market participants indicated that FIS issued in the DIFC, UAE, GCC and MENA are either somewhat liquid or liquid.

#### Interview findings

- The entities interviewed indicated that the success and sustainability of any FIS market depends on several important factors which include:
  - » The number and size of FIS issuances by UAE companies;
  - » The number and size of FIS issuances by local governments (which also helps in establishing a reference yield curve);
  - » The terms and conditions of FIS issuances (e.g. maturity and call provisions) which may impact demand based on investor preferences. The interviewees indicated that, in general UAE investors prefer shorter maturities of FIS, while international investors prefer longer term maturities;

- » Obtaining credit ratings of the issuers and issuances to expand the pool of international investors who can buy UAE issued FIS;
- » Availability of dealers and market makers heavily trading the FIS issuance;
- » Active participation in the market by UAE investors (e.g. institutional and individual customers) since international investors look at the trading patterns of the UAE market investors before making significant investments in the UAE market. International investors buy FIS of companies and issuers that are favoured by UAE investors; and
- » Whether the FIS are viewed as proper collateral in regards to financing activities.

- In general, the entities interviewed indicated that it appears that the level of liquidity of FIS is relatively acceptable. However, several of the entities interviewed commented that they have seen a reduction in general liquidity in the FIS market. The entities interviewed indicated that it appears that newly issued bonds are traded heavily in the first week of trading and then trading slows down until there is some form of credit event or liquidity event. For several of the interviewed entities, the reduction in liquidity is due to the following reasons:

- » Underwriting of FIS of UAE companies is dominated by a few banks, which buy and hold (for their own accounts) the majority of the FIS underwritten by them. This behaviour results in a reduction of the FIS floating in the market, which in turn, greatly reduces liquidity and appeal of UAE issued FIS to international investors. Some interviewees indicated that imposing concentration haircut/capital charges on the banks that underwrite and hold large percentages of the FIS they underwrite may help increase the liquidity and depth of the market for FIS of UAE companies;
- » Active participation by local and regional pension funds and insurance companies in the securities or derivatives markets, will

contribute to a more robust and healthy FIS market. Certain International funds and insurance companies are also prohibited from transacting in unrated FIS, which prevents them from investing in the FIS of UAE issuers that are unrated;

- » A general reduction in firms holding inventory because it has become too expensive due to new regulation which is increasing the cost of holding inventory;
- » UAE investors in general, tend to hold FIS to maturity which depresses liquidity;
- » FIS which are expensive to source in the repo market are typically less liquid; and
- » Sukuk are typically less liquid because of limited supply.

- In addition to the information noted above, most of the interviewees noted that prior to the recent economic slowdown, UAE companies did not face any significant hurdles in securing the financing and loans they needed from UAE banks. Accordingly, there were no major incentives for UAE companies to issue FIS to raise the funds they needed to finance their business activities. However, due to the change in economy and reduction in oil prices, UAE companies and governments are looking to the market to raise the needed funds and are starting to do so through issuing FIS; and

- With respect to the levels of FIS inventories held by dealer/banks, the responses to the online survey responses seem to provide a picture that may not be in line with the responses provided by the interviewed firms. While the interviewed firms have indicated that the levels of FIS inventories held have decreased, the online survey responses have shown that among the firms that hold inventories, the average daily face/par value of the inventories held by them have either increased or stayed the same (50% increased and 30% stayed the same) over the last three years.

## 6.5 TRANSACTION REPORTING

### A. TRANSACTION REPORTING

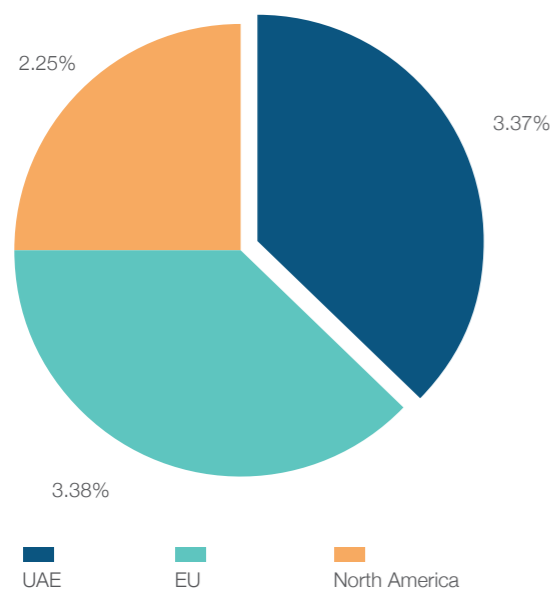
#### Survey findings

- With respect to regulatory transaction reporting of FIS transactions, six (6) dealer/bank respondents indicated that they report their transactions in FIS. Of the six, one (1) indicated it reported to the UAE and EU, two (2) solely reported to the UAE, one (1) reported to the EU and North America, one (1) solely reported to the EU and one (1) solely reported to North America. Please see Figure 14 for more information; and
- In addition, three of the dealer/bank respondents indicated that they directly reported their FIS transactions to the regulator and the remaining three respondents reported their FIS transactions to the regulators via affiliated entities.

#### Interview findings

- The interviewees indicated that there are no regulatory requirements to report each FIS transaction arranged and/or executed in the DIFC

**Figure 14:**  
Transaction Reporting (Dealers/Banks)



to the DFSA, UAE or SCA. However, to the extent that FIS transactions are executed abroad in a jurisdiction that mandates regulatory reporting of every FIS trade, then the firm or affiliate that conducted the overseas FIS transaction will report the FIS transaction to the jurisdiction mandating the trade report;

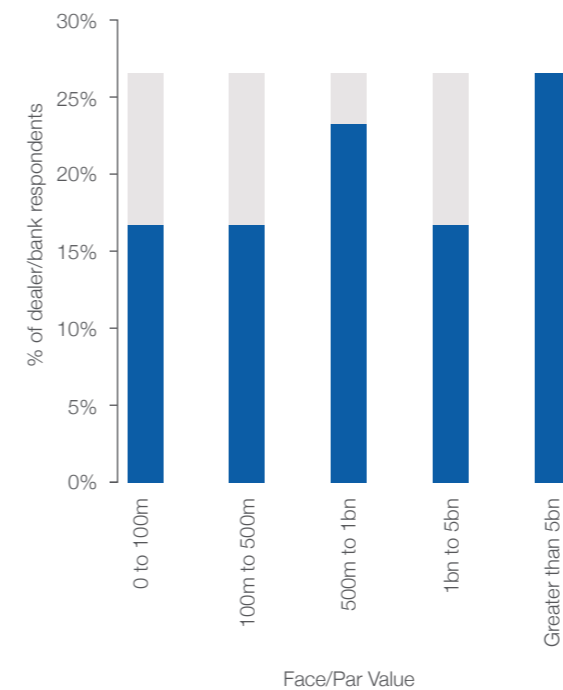
- The interviewees were asked about their views on regulatory reporting of FIS transactions and they have generally indicated an understanding of the benefits of regulatory reporting and dissemination of the FIS transactions reported. Certain interviewees also indicated that regulatory reporting would be a step in the right direction as it would increase transparency. However, they also point that the regulatory reporting requirements should be in line with the international regulatory reporting requirements. With respect to dissemination of the FIS trade reports, asset managers stressed that trade dissemination should be undertaken in such a way that would not move the market, give away or undermine the trading strategies and goals of the entities trading in the FIS market; and
- Some of the interviewees that utilise information providers (e.g. third-party data providers) to arrange and/or execute FIS transactions will also use the same information providers to report on their behalf those FIS transactions that must be reported.

## 6.6 CLEARING AND SETTLEMENT

#### Interview findings

- With respect to settlement and clearance of fixed income securities transactions, a majority of the market participants interviewed indicated that clearance and settlement of FI securities transactions occurs in Euroclear or Clearstream via the delivery vs payment and receipt vs payment (DVP/RVP) process. The market participants also indicated that the fact that there is no UAE based CCP for clearing and settlement of FI securities does not hinder their fixed income securities

**Figure 15:**  
FIS transaction Activity by Value for 2015  
(Dealers/Banks)



activities. Most interviewees indicated that the only way to get FIS transactions to be cleared and settled via a UAE/DIFC CCP is if the regulatory authorities mandate clearing of UAE/DIFC issued FIS through UAE/DIFC CCPs.

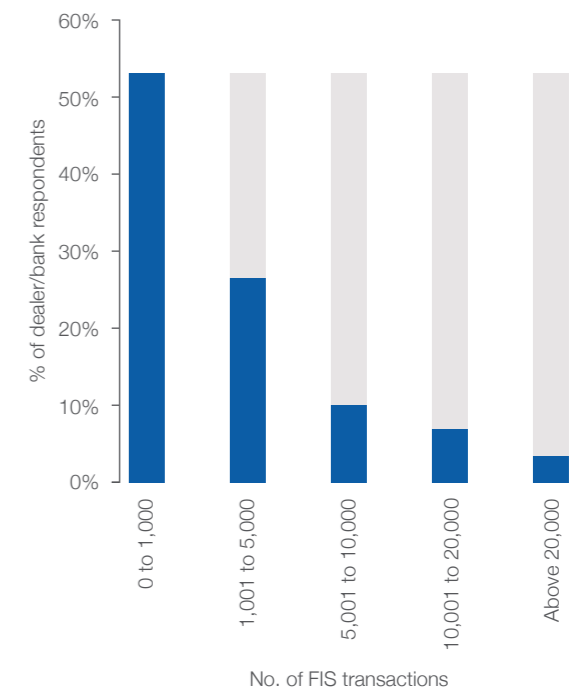
## 6.7 TRANSACTION ACTIVITY

#### Survey findings

The data and information below are based on the data provided by the dealer/bank respondents for calendar year 2015.

- Figure 15 shows that 43% of the dealer/bank respondents surveyed conducted FIS transactions worth more than USD 1 billion (face/par value) each, annually. In addition, Figure 16 reveals 47% of the dealer/bank respondents surveyed conduct more than 1,000 FIS transactions each on an annual basis. The survey also revealed that 10 (33%) of the dealer/bank respondents maintained inventories of FIS and the remaining 20 (67%) dealer/bank respondents did not maintain inventories of FIS;

**Figure 16:**  
Number of FIS Transactions for 2015  
(Dealers/Banks)



- It also appears that the dealer/bank respondents are more active in FIS that are issued in certain jurisdictions. For example, the survey responses revealed that about 25% of the FIS transactions conducted by the dealer/bank respondents were in FIS issued in the EU, 15.6% were in FIS issued in North America, 14.2% in FIS issued in the UAE, 14.1% in FIS issued in Asia, and 6.7% in FIS issued in the DIFC. Please see Figure 17 for more information;

- Figure 18 shows that the dealer/bank respondents are active across almost the full spectrum of FIS but are most active in sovereign bonds/Sukuks and investment grade corporate/government-related entities (GRE) bonds. Specifically, 100% of the dealer/bank respondents surveyed conducted FIS transactions in sovereign bonds, around 87% conducted FIS transactions in investment grade corporate bonds, 67% conducted FIS transactions in supranational bonds and around 63% conducted FIS transactions in investment grade Islamic-corporate bonds;

**Figure 17:**  
Transaction Activity by Issuer Location for 2015

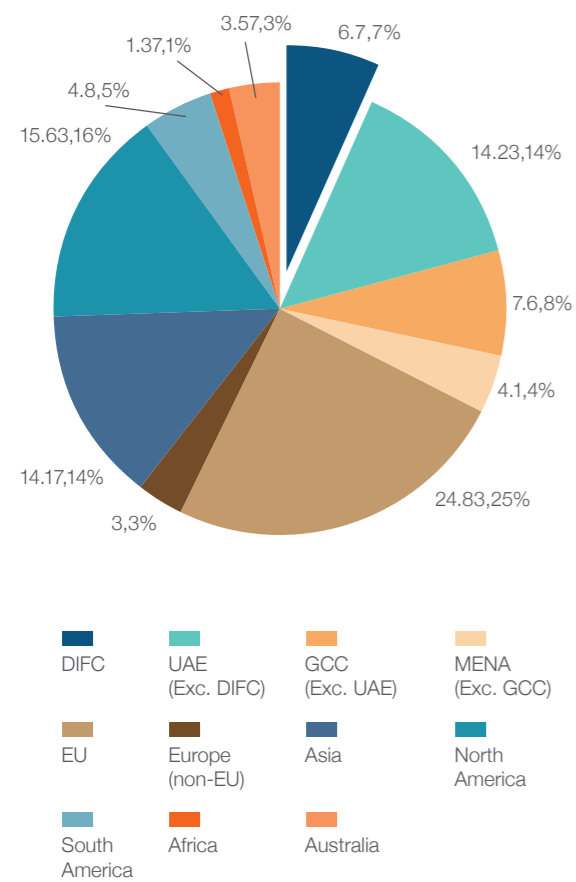
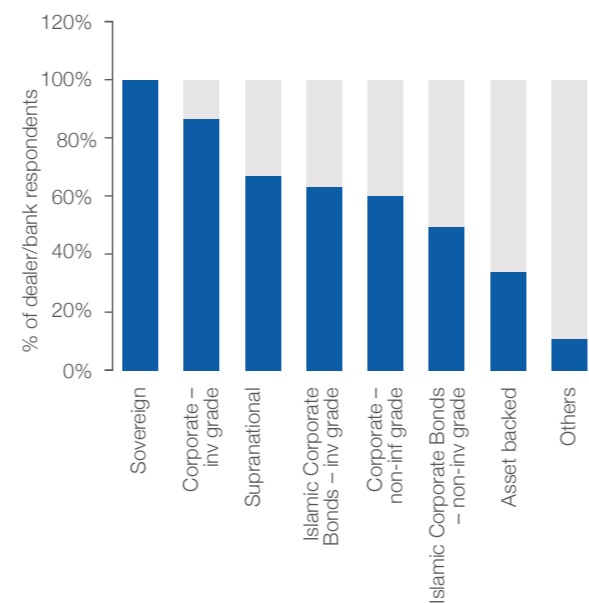


Figure 19 identifies the locations of the customers on whose behalf the dealer/bank respondents conduct FIS transactions. Figure 20 shows the level of FIS activity conducted by GCC customers by jurisdiction. For example, Figure 20 shows that about 38% of GCC customers purchase or sell FIS issued by issuers located in the EU. Figure 21 is similar to Figure 20, except that it shows the data for non-GCC customers. Analysis of the activity by GCC and non-GCC customers, reveals that the FIS activity by GCC and non-GCC customers is somewhat similar with respect to the FIS that attract a medium level of activity but both customer categories diverge when it comes to the FIS that attract a high level of activity. Specifically, GCC customers have clear preferences for UAE

**Figure 18:**  
Types of FIS Transacted in 2015 (Dealers/Banks)



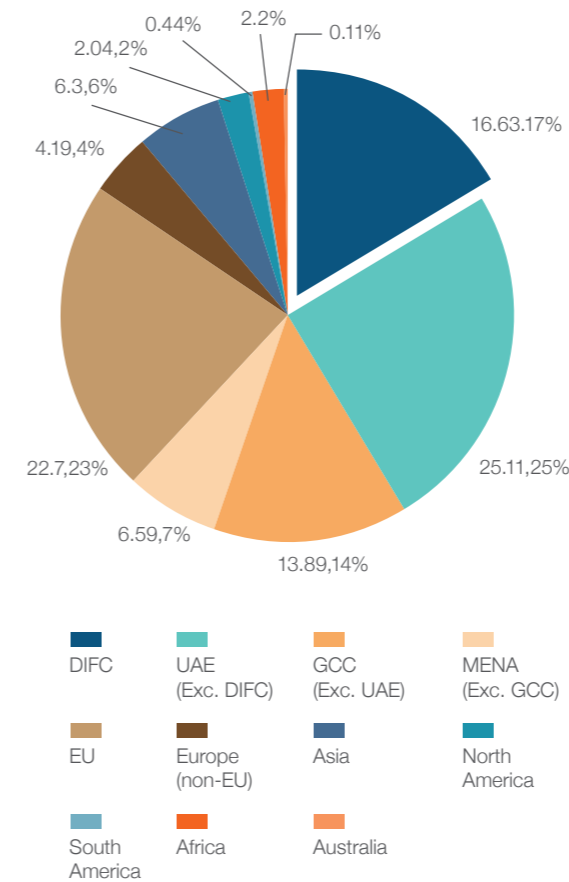
ex-(DIFC), GCC ex-UAE, EU and Asian FIS, while non-GCC customers have clear preferences for EU and Asian FIS; and

- With regard to asset managers, 91% said they arranged or executed FIS transactions worth up to USD 100 million each per year and 9% arrange or execute FIS transactions worth between USD 500 million and USD 1 billion each per year.

## 6.8 RESPONDENTS' COMMENTS

As part of the FIS project, DFSA asked market participants to provide their views on the various challenges and obstacles that hinder the growth and development of the FIS market in the UAE. Their views can be categorised into two general categories: "Regulatory, Geo-Political, and Legal Comments and Challenges" and "Business, Operational and Structural Comments and Challenges". The relevant comments

**Figure 19:**  
Transaction Activity by Customer Location for 2015



made by the market participants through the in-person interview and the online survey are noted below:

### 6.8.1 REGULATORY COMMENTS AND CHALLENGES

- A few market participants felt there were no material regulatory impediments preventing the development of the FIS in the DIFC;
- The respondents' perception is that the GCC and UAE markets would benefit greatly from having regulatory frameworks that are aligned with one another and international standards. Passporting arrangements would also support further growth of the market;

- Printing and reporting times and sales of FIS transactions should be mandatory; and
- Lack of full coordination between local/regional regulators and not properly aligning financial regulations across jurisdictions restricts the activities of market participants in FIS across local and regional jurisdictions, which reduces transactional volumes and liquidity.

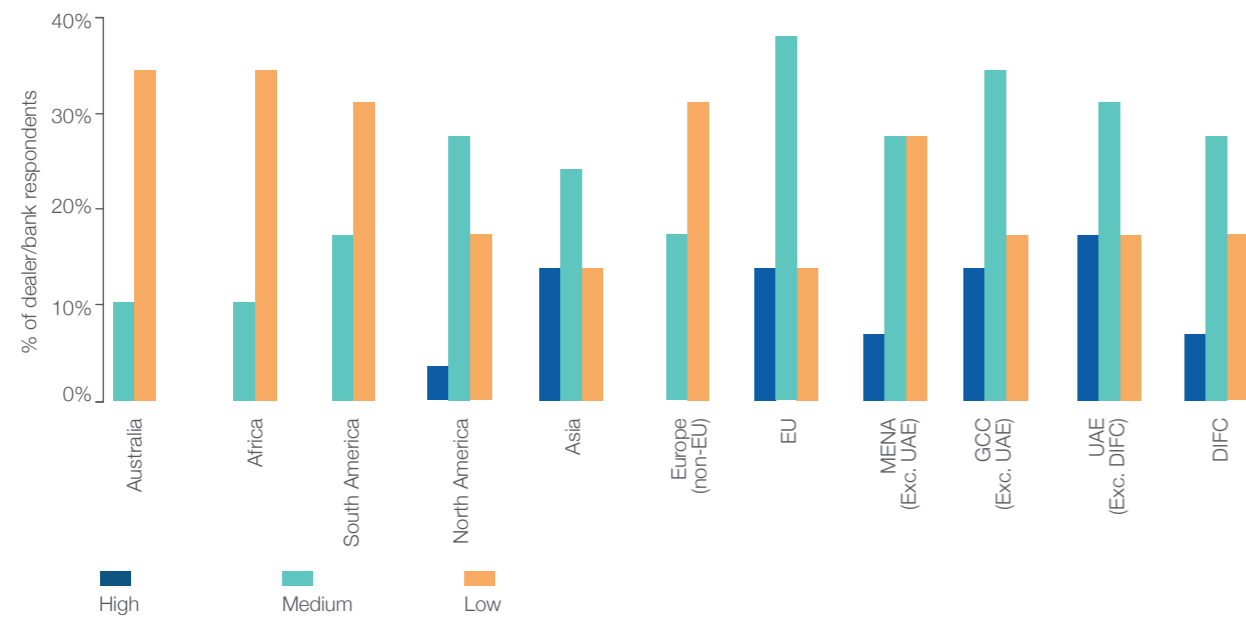
### 6.8.2 GEOPOLITICS AND REGULATORY CHALLENGES

- There is some apprehension about geo-political risks in the GCC;
- There is a need to establish a clean netting jurisdiction in the GCC. Some firms are aware of the fact that the DIFC has a netting law but it appears that some respondents lack legal clarity as to the enforceability of the netting law or how it will work in a real life situation; and
- The approval of the UAE Federal public debt law is expected to increase investor's confidence in the market and hence assist in accelerating the development of capital markets in the UAE and also that of the DIFC.

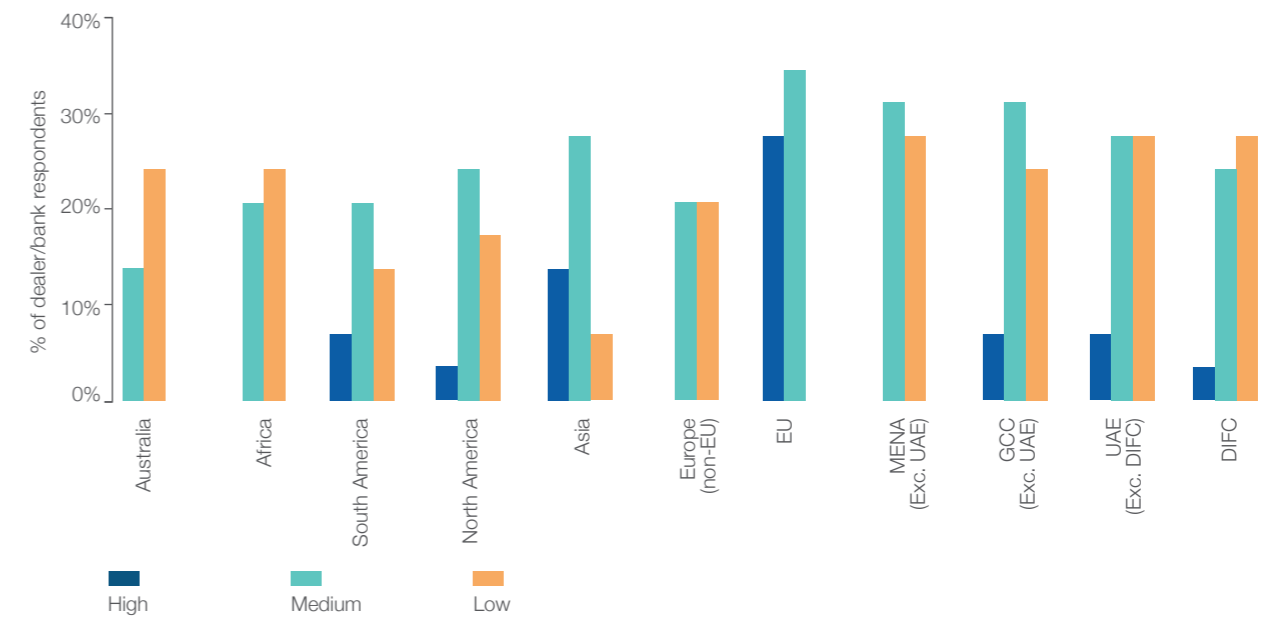
### 6.8.3 LIMITED MARKET DEPTH AND LIQUIDITY

- There is a perception that the total market size is not large enough. FIS issuances are generally stand-alone issuances rather than programmes, therefore limited in scope of size and depth of the FIS market. There are no sovereign issuances to help set a yield curve for the market. These factors contribute to emphasising the international customers' view that the FIS market in the UAE and GCC is too small and therefore does not justify international investors' focus;
- Underwriting FIS of UAE companies is dominated by a few banks that tend to also buy and hold most of these securities for their own accounts.

**Figure 20:**  
GCC Customer FIS Activity Level by Issuer Jurisdiction for 2015



**Figure 21:**  
Non-GCC Customer FIS Activity Level By Issuer Jurisdiction for 2015



This practice has led to a reduction of FIS floating in the market, and in turn, may reduce the appeal of UAE-issued FIS for international investors. Timely and complete transactional FIS data reported to the DFSA would assist in verifying whether clients are receiving fair and reasonable prices. Some interviewees indicated that imposing concentration haircut/capital charges on the banks that underwrite and hold large percentages of the FIS they underwrite may help increase the liquidity and depth of the market for FIS of UAE companies;

- The strong demand by banks does not provide the necessary incentive to UAE companies/issuers

to rate their FIS securities. The lack of rating, in turn, prohibits or prevents certain international institutional clients whose investment mandates require them to buy only highly rated securities from buying UAE issued FIS. If the issuers feel the need to attract a much wider base of large international institutional customers, and if they want to issue FIA at lower rates, they may find it necessary to rate their FIS;

- The depth and breadth of the UAE and regional investor base could be enhanced by allowing institutional investors such as pension funds and insurance companies to invest their funds (e.g. customer assets, premiums, etc.) in the securities

or derivatives markets. This may significantly improve the depth and diversification of the investor base and FIS market;

- Due to recently added financial regulations (globally) and the resulting increase in financial charges for holding inventories, there is a general reduction in firms holding inventory because it has become too costly. This in turn may decrease the liquidity and trading in FIS; and
- Sukuk are typically less liquid because of limited supply.

#### 6.8.4 OPERATIONAL IMPEDIMENTS

- Enhancements can be made to operations, accounting, custody and settlement processes such as:
  - » Improving back office operations and ensuring proper staffing; and
  - » Streamlining and enhancing the custody regime, settlement cycle and accounting structure.



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