

CHALLENGES OF ASSET MANAGEMENT IN THE GCC

DEBATE AND DISCUSSION

CORPORATE GOVERNANCE IN THE MIDDLE EAST

A **MONEY**works publication

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The timing of **MONEY**works' first Asset Management Summit on the challenges of asset management in the GCC could not have come at a better time. The liberalisation of the real estate industry, the opening of international financial centres and the growing requirements for regional investment opportunities in the GCC provide the right opportunity to discuss some of the topical issues that contribute and influence the industry, regulators and decision makers

The entire asset management industry in the GCC stands to gain much from the initiative to document this Summit in order to preserve and record the debate. Happy reading.

Martin Saldamando, Project Editor

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the report

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About this MONEYworks Summit Report

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Introduction

The Gulf Cooperation Council (GCC) regional asset management industry can be said to be just emerging, although over the last three years it has grown exponentially. At present, the entire GCC region has an estimated US\$60-65 billion of assets under professional management (AUMs), of which US\$52 billion are spread across some 500 funds. (*Sbuua Capital 2007 research*)

In the GCC today, Saudi Arabia is by far the largest market with almost half of regional funds, and it also has the highest number of funds in comparison to the other GCC states. Kuwait ranks second in terms of number of funds, and this is followed by the UAE and Bahrain consecutively.

The UAE is estimated to currently have about US\$6.5 billion of assets under professional management. Real estate funds have registered the most prominent increase in size, from an average of US\$45 million in 2004 to US\$1.9 billion in 2006, according to the Gulf Venture Capital Association (GVCA) annual report published in 2006.

There is still significant room for growth when one compares the figures to those of the city-states of Hong Kong (US\$47 billion) and Singapore (US\$20 billion), according to a report published by Cerulli Associates.

The outlook for the next five years is conservatively described as favourable by some. To others, it's potentially euphoric. There are estimates of an industry growing by as much as 23 per cent to

reach close to US\$200 billion of total assets under professional management by 2012.

Analysts agree that the UAE will be the most prominent target in the strategic allocation of most institutional funds focusing on the Middle East. Even sceptics agree and say that what is being witnessed is extraordinary explosive growth within the financial services industry in the Gulf.

Typically, investment banks in the GCC divide their asset management operations between retail funds, open to institutions and to the public, and portfolios which are usually bespoke for special high net worth clients and institutional investors.

Some executives at these banks are certain that the liquidity in the region, which is driven by oil revenues, will find its way into the asset management industry and see the positive growth in AUMs based on expected global equities and the future development of capital markets.

In the future, it is also expected that more international institutional investors will enter the regional market, which to date have been elusive, and this will bring not only a fresh pool of funds into the market, but also much needed technical knowledge.

The experience of western investment management professionals will benefit the regional players who will be exposed to new funding ideas, options and strategies as well as tried and tested research practices, which private equity and venture capitalists inside the region



may not be used to offering in a market where the inner workings of many businesses remain undisclosed.

Global investors have had harsh lessons in the past; an example would be the lack of disclosure that led to the infamous Enron debacle. In light of that and other disasters, regulators across the developed stock markets are continuously working on disclosure rules and regulations to ensure investor rights and safeguards in the future.

A key factor in attracting foreign institutional investment to the Gulf region is confidence, and that can only be gained by creating strong governance systems and an internationally accepted regulatory environment, transparent practices and accounting regimes.

Although regional capital market authorities are working to introduce corporate governance codes, progress has been slow and enforcement challenging.

“The number one obstacle we face today due to the state of the UAE regulation as it stands now is providing assurances and raising a foreign investor’s comfort level,” says Haissam Arabi, Shuaa Capital.

This **MONEY**works Summit – Challenges of Asset Management in the GCC, held on Wednesday, September 5, 2007, was attended by some of the top asset management executives, policymakers, lawyers and regulators in the region, each sharing their insight on the best way forward for the industry.

The Summit participants looked at five key enablers of growth for the industry going forward – 1. Legal frameworks; 2. Integration of multiple regulatory bodies and processes; 3. Regulatory openness to asset management; 4. Corporate governance standards and 5. Access to information.

The debates revealed a multiplicity of thoughts and opinions, but above all, a consensus was apparent that these enablers must be facilitated by the regulators and the industry itself urgently.

The goal of the Summit was to initiate a dialogue between all of the participants in an effort to promote the growth and attractiveness of the UAE and the greater GCC asset management industries to foreign institutional investors by identifying the key enablers, assessing them in light of the local market and suggesting ways to overcome the blocks to business.

The first speaker was Emmanuel Givanakis, who is the associate director of supervision at the Dubai Financial Services Authority (DFSA).

As one of the major financial services regulators in the Gulf, the DFSA is the authority overseeing the Dubai International Financial Centre (DIFC), a purpose-built financial free zone in the United Arab Emirates (UAE). It has been established as part of the goal to position Dubai as a recognised hub for institutional finance, and as the regional gateway for capital and investment in the Middle East.

Givanakis presented the DFSA’s views with regard to regulating the financial services industry in the UAE, the region, and globally. He spoke with particular focus on the uncertainties besetting the nascent asset management industry in the Gulf.

Also speaking was Dr. Nasser Saidi, the executive director of Hawkamah Institute for Corporate Governance, who offered a compelling presentation on The Value of Good Corporate Governance for Asset Managers and Investment Professionals.




“The number one obstacle we face today due to the state of the UAE regulation as it stands now is providing assurances and raising a foreign investor’s comfort level.

Haissam Arabi, Shuaa Capital”

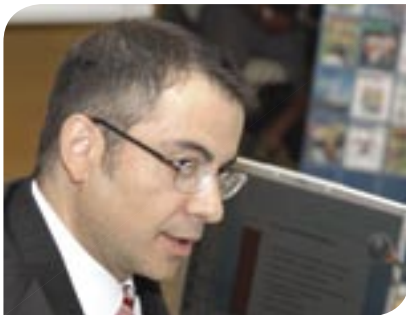
Comprehensiveness and application of legal frameworks in the region

Legal Frameworks

At the regulatory level, a wide variability exists across the GCC states in terms of the comprehensiveness and application of the legal frameworks that govern foreign investment into the region.

Over the past few years, several GCC countries have initiated serious efforts to upgrade their regulatory frameworks, as evidenced by the enactment of new laws.

In Saudi Arabia, the new Capital Markets Law (CML) was passed in 2003. This Law is seen as a landmark for economic liberalisation, as it will create a legal and regulatory framework for all capital-related activities and trading in securities. The CML also aims to increase transparency and accountability, and to attract foreign investment.



Emmanuel Givanakis, DFSA

“Today, the challenge we face as a regulator is in terms of understanding what the legal certainty is of the asset manager over the particular assets that they may have under their control.”

The Saudi CML also makes a clear distinction between the roles of brokers and that of portfolio managers who, on the basis of a contractual arrangement (or otherwise), manage either securities owned by a person or investment funds owned by a natural or legal person that are intended for investment in securities.

This illustrates a particular desire on the part of the Saudi legislature to regulate existing portfolio managers operating in contravention to existing

restrictions laid out by the Saudi Arabian Monetary Agency.

In Bahrain, earlier this year, the Central Bank introduced new regulations to register financial trust funds in the country. The new rules lay down capital and other licensing requirements for trustees and follow the introduction of Bahrain's first Trust Law enacted last August. Among other stipulations, the new rules require the minimum capital for financial trust companies to be at least equivalent to US\$200,000.

A trust is a legal arrangement under which the legal and beneficial ownership of assets are separated, and it has been argued that such arrangements are sorely needed in this region, where ownership over assets under management is fraught with uncertainty.

The Bahrain Trust Law was seen as a particularly innovative move for a GCC state, since the concept of a financial trust agreement is not recognised by most of the regulatory jurisdictions in the Gulf region, including by the UAE. In the west, a number of real estate funds are held in trusts, and hence their attractiveness to investors eyeing the lucrative rise of Gulf real estate.

The present regulatory developments 'onshore' in the UAE are, comparatively, at the more formative stage in that regulators like the Emirates Securities and Exchange Commission (ESCA), the Dubai Financial Market and the Abu Dhabi Securities Market have just begun to put their own regulations into place and raise awareness about the same through the local media.

The DIFC has also issued a Trust Law and continues to issue a raft of new legislation. It also regularly provides access to consultation papers on its website for input from the industry itself, prior to finalising new laws.



Givanakis pointed out that there is still much to clarify, and many uncertainties still admittedly remain.

In his presentation Givanakis said that the foremost challenge, above all, is the ownership restriction in the GCC. This was overwhelmingly agreed to by all the participants - and initiated by far the lengthiest discussion of all topics debated by the assembled professionals.

“Today, the challenge we face as a regulator is in terms of understanding what the legal certainty is of the asset manager over the particular assets that they may have under their control. What are those contractual obligations, and how do they work? Where is the true legal title to the asset? Asset managers must understand what their legal title is [over those assets],” Givanakis stressed.

A prominent UAE lawyer, Amjad Ali Khan, a founding partner of the law firm Afridi & Angell Legal Consultants, said, “In fact, the current regulatory structure in the UAE overseeing the onshore management of investments is fairly dangerous. The current structure is that you get one or perhaps more than one member of the board of directors of a bank together, and they are the investors. That is the ownership of the fund. There are no laws with regard to ownership on a beneficial or a legal basis, and there is no formal structure of the trust agreement.”

Continuing on this point, Haissam Arabi, managing director, Shuaa Capital, argued, “It is structurally a contractual obligation (rather than a trust agreement), but more importantly the fund is holding the shares in the name of the fund in a nominee account on behalf of shareholders.

“Now if an asset manager is going to be doing it that way, that means the fund is not a legal entity. And, most of the time if you are giving custody, most banks can be the custodian, and since custody laws in the UAE are also non-existent, you have the title to those shares in the name of the bank.”

He continued, “Now with regard to the laws, there is a tiny little article [rule] which says you can have a segregated account...but that is just not enough comfort for foreign investors.

There has never been a case where an asset manager defaulted, and so we don't know what actually happens in that situation, whether the (UAE) Central Bank is going to seize all the assets or not,” he said, alluding to a scenario whereby an investor's assets may be frozen for a period of time until the liquidation of the company.

“However, for a fund domiciled in the DIFC, it is a company structure, and so is a legal entity and there is more comfort for international investors.”



Farab Foustok, NBD

“So, the rules are very vague and unclear, and therefore, definitely in comparison to what the DFSA has put in place, the gap between the UAE onshore regulatory regime and the DFSA regulatory umbrella is very wide,” he added

Arabi continued, “Regardless of this, we are forced in some situations to use UAE Central Bank Regulation on this (which is no more than 15 pages) because otherwise you don't have access to the local market. So that's the main reason why we would have some funds domiciled in the UAE, whereas the rest of the funds are still predominately domiciled offshore.”

Amjad Khan summed up his own comment by saying, “The UAE Central Bank is completely aware of this. It recognises it, and it encourages banks to form funds offshore, in Bahrain.”

These discussions prompted a query from the Summit's mediator, Matein Khalid of Bin Zayed Investments, who asked whether such encouragement to form funds offshore in Bahrain may indeed be counter-productive, implying the UAE Central Bank's focus should instead be to facilitate asset managers in their due diligence requirements with regard to providing legal certainty to investors onshore.



The issue of onshore versus offshore establishment of funds and their regulation was raised by Givanakis, who agreed that it is a big challenge for everyone because, "If the private equity legal structures in particular are set-up in what might be referred to as an offshore jurisdiction, then the operator (or the limited partnership, in particular) is established in that offshore jurisdiction, and possibly the investment manager is too, and then there is a delegation down to possibly an asset manager here in the GCC."

With such a structure, Givanakis asked, "How does the regulator appreciate what the risks are with regard to that relationship? For instance, the directors...are they common directors in the offshore jurisdiction as they are here in the GCC? Where will the regulatory

business perspective rather than having virtually no regulation at all. I think a couple of the things that we need to consider are that there is very little difference between a firm like ours, which is based in the region, and a lot of other firms which are selling their products in the region without actually being regulated in the region. And that is unique."

"There are very few countries in the world where you can have people operating from other parts of the world and not being regulated locally," said Bindal.

A lack of clarity regarding legal ownership is certainly one of the most important due diligence challenges faced by asset managers, especially with regard to investments in real property and equity in companies, and therefore



Amjad Ali Khan, Afridi & Angell Legal Consultants

“In fact, the current regulatory structure in the UAE overseeing the onshore management of investments is fairly dangerous. The current structure is that you get one or perhaps more than one member of the board of directors of a bank together, and they are the investors. That is the ownership of the fund.”

arbitrage [offshore set-up] potentially occur? That needs to be understood by both the regulators and by the asset managers themselves. The regulators are trying to grapple with these issues and trying to have a proportionate response to them.”

“In particular, I can definitely say that from the DFSA’s perspective we’re trying to create an environment where these types of funds, as well as all funds that fit within our regime, can be vibrant but have legal certainty and have a strong regulatory oversight that gives comfort to everyone - from the market participants to the investors, etc.,” he added.

Echoing Givanakis’s concerns, Harshendu Bindal, head of asset management CEEMA, Franklin Templeton, said, “Clearly, a set of well thought out regulations is better from a

should demand urgent attention from the regulators.

Dino Kronfol, managing director, asset management, Algebra Capital, said the reason you have to deal with domestic laws is, quite simply, commercial. It is your commercial imperative to go out into the local market and be the first mover and take advantage of the licence you have been granted. However, it certainly doesn’t create a level playing field, and that would ultimately allow everyone to participate in a manner that would directly translate into better products for the investor, which is ironically what the regulators are here to do, he noted.

“I think what we have all said here is true...and I think that the fact of the matter is it’s just not right, the way things are done. It is dangerous. It’s not



proper. You are not going to see the development of an asset management industry if you rely on what you currently have in domestic laws," said Kronfol.

The perfection of a security interest, which is the foundation for raising investors' comfort levels, is directly tied into the region's foreign ownership laws. It all boils down to establishing clarity with regard to how the GCC and the rest of the markets really are going to deal with foreign investment, either direct investment or in the markets.

The participants also voiced their frustration with the pace of legislative change, which so far has been slow to develop, slow to pass and then slow to implement.

Givanakis pointed out that the DFSA sees the challenge more broadly as

international investor's point of view, there is a liability issue in that.

"However, for a fund domiciled in the DIFC, it is a company structure, and so is a legal entity and there is more comfort for international investors," she said.

Matein Khalid asked the participants as a group, "So would you agree that in order for asset managers to attract more international institutional investors, a DFSA regulatory umbrella almost becomes a pre-requisite?"

"I wouldn't go so far as to say it is a pre-requisite," answered Haissam Arabi of Shuaa Capital, "but I definitely think that it serves you better as an asset manager to be domiciled in the DFSA. It gives a lot more institutional credibility,"

Since passing a Trust Law in the DIFC, the DFSA is also reportedly

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Dino Kronfol, Algebra Capital

one that is included in the regulatory challenges of the GCC region as a whole, and even may also be relevant more globally.

"Because in other emerging market areas, for example in China and in India, also in North Africa and the greater Middle East, there are different laws with regard to foreign ownership when an asset manager is going into those jurisdictions to take on assets on behalf of their clients. There too asset managers need to understand what the positions of legal titles are in those jurisdictions," he said.

Farah Foustok, head of asset management, National Bank of Dubai, also shared her view that a fund that is domiciled in the UAE is not technically a legal entity, and she supported the views of her colleagues that, from an

looking into the concept of Trust Structures in regard to providing certainty about ownership for assets under management. Both Corporate trust structures, but also more importantly, trust structures with regard to property funds.

However, the questions that emerge with regard to the latter are - who can own property? Who has the legal title over the property in a property fund? What are the risks for those participants in the market place, when they say that they hold those assets, but potentially do not legally hold them?

These are very important issues that need to be resolved by the asset managers, but also need to be understood by regulators themselves, in terms of understanding the participants within the market place. HW



Integration of Multiple Regulatory Bodies and Processes

Regulatory Bodies

The effectiveness of the supervisory processes which regulators employ to oversee the asset management industry in the region vary considerably, and with so many regulators and regulatory frameworks to deal with, the fragmentation of control is inevitably wreaking confusion and placing costly barriers in the way of business.

The quality of the regulators and their frameworks are not in doubt, as much as the lack of coordination amongst the regulators, and the sovereign countries under which they operate.

Within individual GCC states there is also a need for clarification with regard to any overlapping responsibilities the regulators may share with other governmental entities.



Naveed Ahmed of Dubai Islamic Bank

“I think the challenge is that when you have so many financial institutions, and now you have a lot of boutique banks and people selling from the DIFC, from here, from there, I just don't think the impetus has been there to self-regulate the industry.”

In the UAE, the need of the hour is to introduce a single investor code between the Abu Dhabi Securities Market and the Dubai Financial Market and to have it implemented by the Emirates Securities and Commodities Authority (ESCA). This would be an extremely important step in accelerating the performance of the two markets on a practical level, easing up the work of brokers and traders, and expediting

financial transfers without utilising additional steps.

Such a move would also attract more local and foreign investors into UAE financial markets. The lack of integration has caused many institutional investors to hold off on investing in the Gulf region. So for the time being they are just sitting, waiting and watching, continuing to invest overseas and hoping to invest in this region one day.

Currently, thousands of UAE nationals and residents owning an investor code to deal with the Abu Dhabi market are unable to deal with Dubai's market, and vice versa. They are unable to open accounts in both markets for technical and geographic reasons.

With regard to regulating the asset management industry in the UAE, the responsibility is now shifting from the UAE Central Bank to ESCA. ESCA is trying to move forward and aggressively reform the investment management industry, and industry executives expect to see more regulation from ESCA to tighten control on the onshore industry.

Last April, ESCA issued corporate governance controls applicable to all joint stock companies established in the UAE, companies listed on the UAE stock markets and the board of directors of such companies. The regulations make it mandatory for companies to prepare a governance report containing detailed accurate information on disclosure and transparency.

Meanwhile, the Abu Dhabi Securities Market and Dubai Financial Market have also drafted corporate governance guidelines for listed companies.

Regionally, it has been historically difficult to find common ground amongst the GCC states, and this also hampers the integration of regulatory processes. An example is the ongoing debate on establishing a single currency for the Gulf.



Six central bank governors have made little progress on monetary union criteria, as some members, including Qatar, are yet to agree on how to measure the inflation target. Kuwait and the UAE have also voiced concern about inflation, as the dollar fell around 10 per cent against the euro last year, driving up the cost of some Gulf imports.

Analysts say there are doubts about the feasibility of the original schedule of the currency union, which is 2010, or the future of the dollar peg of GCC currencies.

Since there are multiple regulators in the GCC, if an asset manager domiciles a fund in the DIFC, it is extremely difficult to make that fund available for sale in the rest of the GCC, and the result is that it becomes prohibitively expensive since an asset manager is forced to operate out of multiple jurisdictions.

Obviously, it is very important for the regulatory regimes across the GCC to work together to create a strong market place that is respected globally. Regulatory oversight should not be disproportionate – regulators should aim for a balance, with the objective of not being a blockage to business.

However, since GCC markets don't yet have the maturity of Western markets and the fact that they're changing more rapidly, regulators need to be careful that when they implement rules to establish international best practice standards; they take the best globally, but also consider what suits an asset management company's business here in the Gulf. So there needs to be an appreciation of the circumstances of where and how the investment management business is being conducted.

Sandy Shipton, head of wealth management at the DIFC, supported this view: "The difficulty in finding some kind of commonality throughout the GCC has been shared by all types of communities from political, from military, from economic and other standpoints, not least of which is a common currency. I think the challenge we have goes even beyond the unified currency that everyone is talking about. But I do agree

with you, because every single asset manager wishes to share their product range throughout the GCC."

"I frankly can't see a better badge of approval than the DFSA. When, for example, any of you at this table if you had, if I may say, a lesser stature regulatory oversight, I think you'd have a tougher job offering that product in any of the GCC countries. If you go with a DFSA badge, however, it is equivalent to any of the global regulatory authorities," he said.

"I think the local investor base (as sophisticated as it is) has always sought to invest their wealth elsewhere. Whether it is due to the legal impediments, or whether it is cultural impediments, or whether it is professional impediments, the reality is that the wealth has gone elsewhere. And I think part of what we are trying to bring about, of course, is a reversal of that, and these are some of the issues – title issues, a capacity for asset managers to take good title, and for all investors to be looked at as one investor class," concluded Shipton.

Naveed Ahmed of Dubai Islamic Bank said, "I think the challenge is that when you have so many financial institutions, and now you have a lot of boutique banks and people selling from the DIFC, from here, from there, I just don't think the impetus has been there to self-regulate the industry. Sometimes you need for the (UAE) Central Bank to be responsible for initiating that discussion (as opposed to a bottom-up approach), and really to set up some sort of borders and say 'look, we all need to operate and regulate within this', and hopefully from that, maybe, it would stimulate some of the financial institutions to work together to self-regulate the industry. But here in the UAE I really think that self-regulating the distribution side especially, is really key."

Some of the participants voiced their opinion that regional regulators should encourage the growth of industry associations as a very strong positive for growth in the market place, and for building confidence in the market place.

“I think the challenge we have goes even beyond the unified currency that everyone is talking about. But I do agree with you, because every single asset manager wishes to share their product range throughout the GCC.
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Principles-based Regulation and Rule Book-based regulation

Rules vs. Principles

Next, the discussion turned to the processes of Principles-based Regulation and Rule Book-based Regulation.

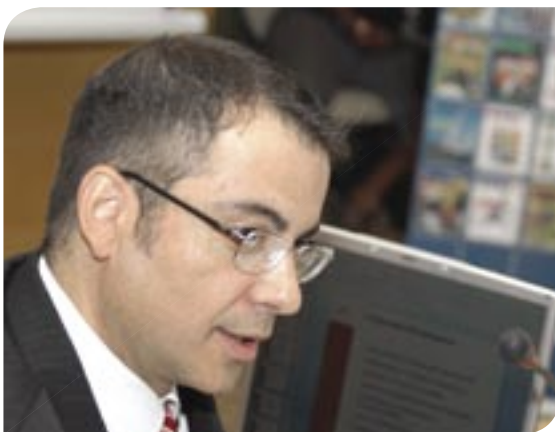
Principles or risk-based regulations set overarching requirements for all financial services firms. These are a set of axiomatic statements that articulate what action and behaviours are expected from firms, and which critically focus on what regulations are trying to achieve. They are expressed in terms of outcomes rather than processes or procedures. In that way, they provide a helpful “if in doubt” guide to the regulated community.

Principles-based regulation is essentially about outcomes or ends while Rules-based regulation is about means. Principles-based regulation allows firms to decide how best to achieve required outcomes and,

Givanakis said, “One of the really interesting things about the [UK] FSA’s approach was that it was going to be supported by a very strict, very black-and-white rule book. And so there is a balancing act between principles-based regulation and rule book regulation. They have to work together, and that was the message that the FSA was sending.”

Givanakis confirmed that the DFSA is also taking a Principles-based approach to their regulations, but the DFSA also has a very strong rule book to support that.

Of course, with the DFSA having a Principles-based approach to their regulations, internal rule-making by firms under the DFSA regulatory umbrella must unavoidably involve positioning their firm somewhere on the regulatory risk spectrum, which ranges from whiter-than-white to aggressive and beyond.



“One of the really interesting things about the [UK] FSA’s approach was that it was going to be supported by a very strict, very black-and-white rule book. And so there is a balancing act between principles-based regulation and rule book regulation.

Emmanuel Givanakis, DFSA”

as such, it allows a much greater alignment of regulation with good business practice.

In the UK, the Financial Services Authority (FSA) rule book itself is becoming much less detailed and prescriptive. In the future, the FSA will rely much more on its Statements of Principle and high-level rules.

This has to be done on the basis of a clear understanding of both the impact on the business of different types of approach and the firm’s approach to such risk.

The UK FSA is deliberately shifting responsibility onto firms to work out for themselves what the principles and high-level rules mean for them. And in relation



to this, Givanakis's direct allusion to the FSA's approach as being commendable, may imply that DFSA regulated firms may also have to do the same.

This work of 'translation' is not only expected by the FSA, it is also essential as a practical matter: it is not sensible or realistic for firms to expect front line business personnel to make decisions based on principles and high-level rules alone.

Translation in effect requires internal rule-making by firms – this includes not only rules that are formally set down in compliance manuals and procedures, but also informal rule-making by ad hoc decisions and interpretations by legal/compliance.

Senior management needs to be appropriately involved in the process, and it cannot be left to the compliance function alone. Firms need escalation systems so that senior management is involved in particularly difficult or important decisions.

More generally, if the firm's compliance arrangements are inadequate or if the FSA's requirements are incorrectly interpreted, or are

speeches, case studies, consultation papers and feedback statements. Firms need to develop systems to ensure they are aware of these resources.

A general guidance may be indirectly inferred from the frequent statements made by Givanakis to the asset managers present at the Summit.

"We don't want to be a block to business. We want business to occur, but to occur in a fashion that is acceptable to the whole market place," said Givanakis.

However, this does not help with regard to the question of regulation outside of the DIFC, in the greater UAE, which was also of paramount concern to the assembled participants.

"Can I ask you a question on that? Outside the DIFC, in the greater UAE, where there is very little regulation and perhaps where there are also some unwritten policies that are not widely known to exist, or widely understood, wouldn't a principles-based program work better, before we move into a rule based situation?" asked Amjad Ali Khan from the Dubai office of Afridi & Angell Legal Consultants.

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Emmanuel Givanakis, DFSA”

“Where there is very little regulation and perhaps where there are also some unwritten policies that are not widely known to exist, or widely understood, wouldn't a principles-based program work better, before we move into a rule based situation.

Amjad Ali Khan, Afridi & Angell Legal Consultants”



insufficiently embedded in the firm's culture, it will be seen as a senior management failing.

The debate is open on the way the DFSA interprets its principles and high-level rules, which will often not be apparent from the rule book itself.

Important informal guidance may nevertheless be available from DFSA

To which Givanakis replied, "In terms of the broader UAE, all I can really say is that the regulators there should really turn their minds to that issue and really have to address it themselves. I think it is an important thing to firstly consider, but also decide upon what their course of action will be, for the broader market and investors and consumers generally." HW



Regulatory Openness in the Asset Management industry

Open Regulation

Both the Dubai International Financial Centre (DIFC) and the Qatar Financial Centre (QFC) enable foreign banks to participate in wholesale financial services, such as investment banking, asset management, insurance and private equity.

Firms based in these 'free zones' cannot, however, do 'banking' business with retail consumers directly. This prohibition was debated by the assembled asset management professionals since it has implications for their businesses going forward.

The emerging GCC investment banking and asset-backed finance industries are uncertain as to whether or not their business is "banking" per se.

As capital markets mature, investment

regime in particular to accommodate those two particular types of funds.

"Now, with Private Equity in particular, one of the things that we specifically did was we made it a little bit easier with regard to custodianship of assets with regard to Private Equity. Whereas we have made the test with regard to other funds more stringent, the bar is set higher.

"With Private Equity, we appreciated and realised that private equity funds and the relationship to safekeeping is a little bit different in comparison to other types of funds," said Givanakis.

Farah Foustok of National Bank of Dubai asked, "What is the stance of the DIFC with regard to retail investors? Public funds right now domiciled in the DIFC cannot be offered to retail investors.



Sandy Sbipton, DIFC

“I do believe that there is scope for discussion in relation to asset management as against the issue of banking business or banking per se, and certainly in dialogue that I have seen with other legal practitioners it is indicated that where, for example, funds come in for the purpose of the exclusive objective of raising an investment fund, that is to say these are not deposits that would be defined as banking deposits, then those funds would fall beyond the retail prohibition.”

banking flourishes, and specialised institutions in mortgage and asset-backed financing emerge in the GCC, the region will more than likely also witness a jump in levels of asset-backed securities in the coming years.

In his presentation, Givanakis focused on two particular types of asset classes that seem to have become very popular over the course of the last five or six years with regard to asset management: Private Equity and Hedge Funds.

"The DIFC, and the DFSA, have really tried to facilitate as much as possible private equity and hedge funds. So we tried to structure our collective investment

Should that change? There could be an argument that retail investors require more regulation than institutional investors do."

At first, Givanakis declined to answer. The restriction imposed on the DIFC not to offer retail banking services to customers in the UAE is a minefield of uncertainty for the assembled asset management professionals, and also for the regulators.

When further pressed by the Moderator, he deftly summed up by saying, "In terms of Collective Investment Funds, the approach that has been taken to date has been one of caution with respect to making sure that the DFSA's



rule book, and the laws within the DIFC are [framed] within the Federal [UAE] Laws which created the Zone in the first place. So it is very important to understand that..."

Sandy Shipton of the DIFC interceded here to say, "Can I offer a comment on that, in the sense that, the retail prohibition that was enshrined in the Financial Free Zone Law was, of course, focused on banking business. And the intention of that retail prohibition was to ultimately protect the UAE Dirham, and the (UAE) Central Bank has absolute responsibility as the lender of last resort."

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summed up the session by saying, "I think that one of the things we have to look at is that despite the lack of regulation, the size of the domestic GCC asset management industry is actually very significant, and if you add to that the liquidity that is anticipated in the region, and the increasing wealth that is being generated and will be invested in the region, I think that just from the commercial angle this will drive things in a positive direction."

"When you are talking about this amount of money (over US\$60 billion in the GCC) being invested in this part of the world through an industry, I think commercial reasons will drive a lot of what goes on going forward in terms of overcoming the challenges. I'm very positive going forward. Just the fact that we are having this discussion highlights that people in the industry have gotten together and started talking about these issues. I feel these issues will resolve themselves over a period of time," said Bindal.

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banking deposits, then those funds would fall beyond the retail prohibition," said Shipton.

Givanakis's final comments on this were that to a large degree, the restriction is self-imposed by the DFSA. Whether that is expanded or not, is very difficult to say. That would be a decision that would have to go to a fairly senior executive level. Obviously, the board of the DFSA would have to contemplate those issues, but there is always the possibility of something being considered in the future.

Harshendu Bindal of global asset management firm Franklin Templeton

Franklin Templeton has operations in the Dubai International Financial Centre and has US\$5 billion (AED18.36 billion) under management in the Middle East, and expects the asset management industry in the region to triple in size within the next five years.

Bindal's words were echoed in the actions of his firm. Just days before the Summit, Franklin Templeton acquired a 25 per cent stake in UAE-based Algebra Capital, a strategic investment aimed at strengthening their asset management capabilities in the Middle East and North Africa region.



Harshendu Bindal, Franklin Templeton



Corporate Governance Standards in the Middle East

Making decisions

Corporate Governance can be defined as the laws, regulations, institutions and enforcement mechanisms that make up a market economy's institutional infrastructure and integrity. Corporate Governance is very much about the rules and procedures and the overall framework for making and taking decisions.

The World Bank, in its definition of Corporate Governance, introduces an ethical slant by defining it as "promoting corporate fairness, transparency and accountability".

Because the stock markets in emerging economies are relatively new, scholarly analysis of these markets is still in its infancy, and we have limited understanding of how weak regulatory institutions affect market behaviour. Some have used this argument to dispel the notion that corporate governance standards really matter to investors in emerging markets.

However, the fact is that the majority of blue chip companies in the region are family-owned enterprises.

Unlike listed companies, which are using other peoples' money, family enterprises are using their own wealth. Herein, corporate governance is critical for succession, for diversification of economic activities, and critical for the sustainability of the family-owned enterprise.

"This is the time at which you have to reform the system. Today is the day that you need to invest in good corporate governance. The reason is very simple - we have never had it so good. There is lots of wealth being generated in the region, growth rates are very high and we are attracting a lot of foreign investment as well. This time around may be the last chance," said Dr. Nasser Saidi, executive director of the Hawkamah Institute for Corporate Governance.

To engage sceptics in the debate about whether good corporate governance standards really matter to investors in

the region, one needs the support of empirical evidence and to depend on information flowing between regulators, the institutional investors and market professionals alike. In this part of the world, garnering such cooperation is a daunting task, and nobody knows this more than the executive director of the Hawkamah Institute for Corporate Governance.

Dr.Saidi started by saying there is no single definition of Corporate Governance. However, the most widely accepted definition is that it is 'the system by which business corporations are directed and controlled'. It is very much about the distribution of rights and responsibilities between all of the stakeholders in a corporation including shareholders, executives, management and whoever works in the company, as well as other stakeholders such as the government and maybe also the society at large.

Haissam Arabi of Shuaa Capital here asked a question, "Since there is no single definition of corporate governance, how helpful is that in rating a company? For example, when one wants to evaluate a company, or do what a credit rating agency does - to look at the price-to-earnings ratio, since such criteria allows one to say whether a company is overvalued or undervalued. Do any such sets of criteria exist for checking Corporate Governance within a company? Are there Corporate Governance rating agencies?"

Dr.Saidi responded, "Corporate Governance can mean different things to different types of organisations. The example I gave is that the World Bank takes a more 'ethical' viewpoint. However, there are indeed criteria, and the rating agencies have developed a whole set of criteria which you can adopt. We adopt them, and I can send them to you. Hawkamah also conducts training courses for asset management professionals that introduce and explain these criteria," answered Dr.Saidi.



Dr.Nasser Saidi, executive director, Hawkamah

“Investing in good corporate governance pays. It is a relatively small investment for huge returns.”



Amjad Ali Khan of Afridi & Angell Legal Consultants also asked Dr.Saidi, “We have had investor clients who have advised companies that they are targeting that about their own Corporate Governance statement and that unless the target company signs up to it, they will not pursue the investment. From the point of view of the investor, have you developed a due diligence questionnaire [set of criteria] strictly relating to Corporate Governance?”

Dr.Saidi replied, “Yes, we have and we are quite happy to share that. There is a questionnaire and also, depending on the type of work, we can also undertake an assessment of the Corporate Governance of a company. We can do that for certain investors too, and some companies have turned to us to help them improve their own Corporate Governance, since they wanted to take an external view.”

“I think it is important that investors have policies to inform target companies that they take Corporate Governance seriously into account before deciding whether or not to invest. I think it’s an important message investors can send out. If companies know that a potential investor will be taking Corporate Governance into account, it can force companies to start changing the way they act,” said Dr.Saidi.

“Investors can also play quite a pivotal role in the improvement of Corporate Governance in this region, especially institutional investors, by going into an entity, investing in it, and not only investing in share value, but also investing with the expectation of putting board members in who will improve the culture of the organisation, and thereby improve Corporate Governance throughout the organisation,” said Emmanuel Givanakis, DFSA.

Dino Kronfol of Algebra Capital asked another important question in relation to evaluating the region as a group of disparate sovereign jurisdictions. “Since Corporate Governance interacts with the legal frameworks and sovereign laws of countries and their public governance, how much leverage does Hawkamah have in assessing or evaluating the actual sovereign country laws under which the corporates have to operate? Do you

actually rank countries in this region, and say for example, that this country is very poor or that they don’t implement their laws, etc.?” he asked.

“The answer is yes. If you look at the GCC reports, we were very open. We visited all the GCC countries and we sat down with regulators. We looked at their laws, we looked at the listing requirements, we looked at any regulations that were issued by the capital markets authorities; and on that basis, we did the ranking for each of the GCC countries. Quite a few of them didn’t like it. I’m not going to name names, but two of the countries in particular would have been very glad to hang me up! But the bottom line is, yes, we did it,” said Dr.Saidi.

To which the moderator Matein Khalid interjected, “Hopefully they were not the ones who issue your residence visa!”

Dr.Saidi continued, “Corporate governance is not just entirely about a checklist.”

“There are also the qualitative aspects of corporate governance, or the relations within the company, and these are much more difficult to measure. These you can only get in direct interaction with the company itself and with its management,” he said.

The guidelines call for direct interaction with the executives and the board members of the company. So, in order to have a comprehensive analysis of a company’s corporate governance level, it is important to look at the set of criteria which is readily measurable, and also to have a direct interaction or meeting with the company itself.

Commitment to Corporate Governance is the first step for a CEO and the organisation as a whole. The entire board has to take on the commitment. How the commitment materialises within an organisation is a critical signal. You can talk about the commitment, but how do you actually put it into practice? Because it is the practice that is critical, and the individuals who are running those processes and procedures within an organisation are also critical for Corporate Governance to actually be successful.

Any governance structure of any

“This is the time at which you have to reform the system. Today is the day that you need to invest in good corporate governance. The reason is very simple - we have never had it so good. There is lots of wealth being generated in the region, growth rates are very high and we are attracting a lot of foreign investment as well. This time around may be the last chance.”



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corporation is the sum of the relationships between three central parties within the organisation, namely the shareholders, directors and management.

Since the shareholders are putting up the capital for the company, they are presumably also the ones who are appointing the directors and the board of directors, and there is a system of representation. That board of directors appoints managers, and managers are then also accountable to the shareholders. “We tend to forget the management part of the relationship between all of the stakeholders,” said Dr.Saidi.

“You very much need a very active, knowledgeable, independent and high integrity board in order to have the structure in place for a well governed company. The majority of the board should be independent non-executives,” said Dr.Saidi.

“So, for example, if you are looking at a company, you might want to ask what does the composition of the board look like? Is the CEO there with his brother and his cousin? Is the brother’s wife acting as the board secretary? Are there business associates also on the board? As opposed to a company wherein the majority of the members of the board of the company are independent, third-parties, not having any direct business relationships with the company itself.

“In this region, but also in other regions of the world, many of the corporate boards are not very active. They tend to be fairly passive, with fairly passive board members as well,” he added.

The most important and appropriate committees in a well governed company structure include the audit and compliance committee. Depending on the size of the company, there should be a variety of these committees overseeing things like nomination and compensation for executives.

Companies might also consider having a corporate governance committee, and some companies (for instance financial services companies) may require an information technology committee, given the criticality of systems

and investments the company needs to make in information technology infrastructure for providing financial services.

Emmanuel Givanakis, in his previous presentation on Regulatory Challenges, developed the following points which relate to corporate governance:

“Subcommittees can also be a great asset to a board in terms of getting the right skills externally to provide information flow into your board to enable the board to make a valid independent decision; exercising its mind as the mind of the company, because the company, from a legal perspective, is a legal entity of its own and this actuality is fundamental to an understanding of Corporate Governance.”

He continued, “There also needs to be a nomination subcommittee, I think, that is a very important tool in Corporate Governance because it allows companies to identify and appoint board members who have the requisite skills for that particular company and its circumstances at that particular time. Because it is very important to understand companies go through different historical variations in their life cycles.”

“A board member, who might be good during a bull run, may not be good during a bear period. A board member who might be very valuable to a mining company doesn’t necessarily mean that they are going to add any value in particular whatsoever to an asset management company or to the board of a fund, for example,” said Givanakis.

Dr.Saidi’s presentation highlighted those points inherent in a well governed company structure. He said that strong financial, risk and auditing controls are important and these committees should not be composed of the same people. If the same people are on all of the committees, you lose a great deal of accountability.

The audit and risk committees should be active, and have clear mandates. Controls should also make sure that committees have limited, if any, related-party transactions.

The issue of Compensation and Succession are critical ones for this



region, particularly since almost 90 per cent of the existing companies are family-owned enterprises.

“Eighty per cent of the companies which are family owned enterprises in the GCC region, do not survive into the third generation,” said Dr.Saidi.

“Fundamentally this is because they have a founder (the patriarch) who established the family business successfully as a good entrepreneur, but of course, they all believe that they will live forever, so they are still running it when they are seventy-five or eighty, and, of course, nobody else understands what the core business is except them. They are the CEO, COO and the CFO, if not also the board secretary. The unfortunate truth is that people die, and if there is not a proper succession planning, the enterprise itself may also end up dying.

“Also, families grow. You start off with two people, and you end up with six people. Furthermore, your children might not agree with you and might not want to be in the family business, and they might want to do something else. So, how a family-owned enterprise addresses corporate governance is critical, particularly for our region,” he said.

Dr.Saidi presented the findings of several surveys conducted by Hawkamah and by other organisations from across the globe to convince the assembled participants that Corporate Governance was indeed making a difference to the bottom line.

At the country level, the surveys indicated that countries with stronger shareholder rights and good investor protection tend to have larger capital markets, have companies with less debt and companies which perform better during periods of crisis. And, at a company level, companies with good corporate governance tend to have higher values in the market, better credit ratings, and access to finance at better terms and for longer periods.

Findings from studies conducted in a number of emerging markets revealed:

- Better Corporate Governance correlates with better operating performance in companies and higher market valuation.

- Good Corporate Governance at the company level matters more when the overall legal environment is weak and when there is weak protection of shareholder rights.
- The differences across countries in the enforcement of laws and regulations affect the ownership structure, market valuations and dividend payouts and also affect the availability and the cost of external finance.

In particular, if you look within countries with weak rule of law and ineffective judicial process you tend to find that the stock markets are small, that companies have difficulty attracting shareholders (because who protects their rights?) and they tend to have more debt, because nobody wants to take a long-term stake.

The moderator Matein Khalid asked an open question, “Do we have any empirical data to support the view that a higher standard of regulation does actually attract business? It seems to me that local funds floated by the UAE Central Bank on the eve of the crash did perfectly fine; they were raising hundreds of millions of dollars and the banks were also providing leverage. Is the investor base in the GCC really discerning? Do regulations and good Corporate Governance matter to them?”

Emmanuel Givanakis made a comment that is appropriate in the context here: “What is the value to share price of having strong corporate governance? Well, the first one is quite simple. If you have good Corporate Governance systems and you have a good culture derived from that, the argument goes, you will attract more investors, and you will attract more capital to your entity.”

“Now, there are differing views, others saying that there is no true value in that. But my personal opinion is that I think there is. Whenever there is a bear market that comes on, the flight is to more well run, better security, and to firms with good Corporate Governance structures because they have made sure they haven’t found themselves in a position of crisis because they’ve been watchful of that,” he said.

“You very much need a very active, knowledgeable, independent and high integrity board in order to have the structure in place for a well governed company. The majority of the board should be independent non-executives.

Dr.Nasser Saidi, executive director, Hawkamah”



Access to information

Accessing Info

In the months running up to the Summit, a debate over corporate disclosure standards had been at the forefront of the UAE financial community's discussion, and investors, individuals and institutions alike have signalled their dissatisfaction by punishing an otherwise attractively-valued stock. The partnership between Emaar and Dubai Holding, which would have increased the government's stake in the real estate company to 51 per cent, was seen by some as a set-back for minority shareholder rights.

In this part of the world, there is less disclosure than in the west, and as an integral part of the development of a stock market, the hope is that international best practices on corporate disclosure will eventually materialise in the GCC.



Haissam Arabi, Shuaa Capital

“One of the reasons is the lack of transparency and understanding with regard to the deal with Dubai Holding.”

In Saudi Arabia last month, the Capital Markets Authority banned the practice of board members and senior executives trading in the shares of their companies in the run up to earnings reports, which is further evidence of the regulator's resolve to stamp out insider trading and improve disclosure standards in the Kingdom's capital markets.

Hawkamah, the Institute for Corporate Governance, is working on establishing rules to enhance the confidence in UAE equities, representing a new point of attraction

for foreign investments. Corporate Governance supports the rights of the minority shareholders, especially in events like general assembly meetings, as they are among the owners of the company.

The participants at the Summit discussed the recent headline-grabbing negative reporting on Shuaa Capital by a regional business/financial magazine, as well as the growth of financial journalism in the region.

Also, both Hawkamah and the Emirates Securities and Commodities Authority have announced training sessions on corporate governance for financial journalists and media professionals in the UAE.

A recent survey shows that Corporate Governance now factors into the investment decisions of foreign investors. Investors look at country level disclosures and governance practices and also firm level improvements in governance and information flows in making their investment decisions. (Source: Leuz, Lins, Warnock, 'Do Foreigners Invest Less in Poorly Governed Firms?' 2005)

More than 84 per cent of institutional investors are willing to pay a premium for the shares of a well governed company over one considered poorly governed, but with a comparable financial record. In both Organisation for Economic Co-operation and Development countries and also emerging market countries, well-governed companies attract premium valuations.

Well-governed firms in Korea traded at a premium of 160 per cent to poorly governed firms, a study by Korean and US researchers found. (Source: Black, Bernard S.; Jang, Hasung; Kim, Woonchan. 'Predicting Firms' Corporate Governance Choices: Evidence from Korea.' University of Texas Law School Working Paper No. 39, August 2004)



“These surveys are another way of saying that investment managers, as asset managers, can play a dual role by being active at the level of Corporate Governance in companies in which they invest. So by instilling Corporate Governance in the companies in which you are investing, you can achieve an even higher return. Anybody involved in private equity investments should consider this seriously,” said Dr.Saidi.

As in the previous session on regulation of the industry, Farah Foustock of the National Bank of Dubai asked Dr.Saidi about retail investors, “Your survey results all refer to foreign direct investments by institutional investors. In this part of the world, where you have less disclosure than in the west, and over 70 per cent of the investors are retail investors, how would you be able to measure the impact of corporate governance?”

He replied, “The empirical evidence says is it not only about institutional investors since well governed companies in general earn higher premiums, independently of who owns them.

“Now it may very well be that institutional investors are more attuned to looking at Corporate Governance than retail investors are, and therefore invest more in companies with better governance, but the fact that they invest more and therefore raise the price also means that retail investors also gain. So the gain is not just for institutional investors.

“The second part of your question is more difficult to answer. You can measure it, of course, and we have started to measure it and develop case studies to the extent that you have public information. But we don’t always have it, unfortunately. Information about beneficial ownership, the number of independent directors and a number of other criteria is not readily available to us in this region.

“We all need to be very active in terms of increasing disclosure

standards and ensuring that we have harmonised accounting practices, which we don’t. There are many stock exchanges in this region where companies can be listed using different accounting standards on each one.

“That’s like telling students, you can use a long pencil but that one uses a short pencil. The results can be very different when you assess them, and particularly for real estate companies. There is a lot of work that needs to be done in this region, in terms of information flow and transparency and disclosure.”

Dr.Saidi added, “Well-governed companies often draw huge investment premiums, get access to cheaper debt and outperform their peers. So asset management companies should evaluate the Corporate Governance structure of companies prior to making acquisitions and investment decisions.”

Haissam Arabi of Shuaa Capital gave a real life example to illustrate the points made in the debate on the importance of access to information

“The development of a country’s asset management industry is strongly dependent on the rule of law.”

and the urgent need for improving corporate disclosure standards in the region.

He recalled the recent collapse of the stock price of Emaar PJSC, one of the largest real estate companies in the region, which he attributed to Emaar’s announcement of a deal with Dubai Holding. “At the time of the collapse, the Emaar stock was trading at about AED13, and [thereafter] it collapsed,” said Arabi.

“One of the reasons is the lack of transparency and understanding with



Dr. Nasser Saidi, Executive Director, Hawkamab



regard to the deal with Dubai Holding,” he said.

“A lot of foreign investors were the ones behind dumping the stock, and we’ve actually managed to speak to them and they told us...

“Now with the government going to own 51 per cent of the company [due to the deal], such a move would absolutely marginalise the minority shareholders to the point where there would not be any minority rights left. And, therefore, we see that as very bad Corporate Governance and hence we are exiting.

“The foreign investors exited at a loss, they did not make money at the time, and they sold huge blocks that they actually bought at the same price, and that is one of the reasons why the stock went down.



Dino Kronfol, Algebra Capital

“Nobody [in the past] would have pointed a finger at any financial institution and said, ‘look, you did something wrong here or there.’”

“This is just an example of how important Corporate Governance is here, and especially for publicly listed companies, and how we need to be aware of that,” concluded Arabi.

It needs to be mentioned here that the purported Emaar and Dubai Holding deal did not eventually go through, as apparently the sponsors saw valid reasons for not pursuing it any further.

Matein Khalid posed an interesting question to the participants about the role of the media. He asked, “I really feel that the UAE financial press has completely let down the investor, I mean all through the asset bubbles it was [reported with] headlines like ‘Markets Going Higher and Higher’. Is there any kind of an analytical paradigm that can help the investor?”

Dino Kronfol of Algebra Capital said, “I believe it [financial journalism] has actually improved, to be honest with you, in the sense that I think you now see journalism and the press a little more critical. Our friends at Shuaa Capital had, unfortunately, a finger pointed at them because you know, being the largest firm, etc., they were sort of held to standards that everyone should be held to, but they were sort of singled out (probably not very fairly), but that sort of criticism was not available in the press a few years back.

“Now obviously the way in which it is done can definitely be improved, and I think that today public relations as an industry is booming, every company now has to sit and consider its relationship with the press, and in that sense I think the press has done a good job.

“The bad part is that the press themselves need to get further educated about financial matters, stock markets, etc. so that they could give the advice and ask the right questions, and if they want to do investigative journalism into financial transactions, then they should be knowledgeable enough to do so responsibly,” said Kronfol.

Dr.Saidi summed up the session with a persuasive insight into how urgent it is to make progress in the region.

He concluded, “If you fritter away the wealth that is being generated, if your companies are not well governed, if you as investment managers make bad investment decisions and invest it not so wisely, then the future of this region might look very bleak indeed.

“So for me, Corporate Governance is about precisely that. I think we all need to become much more active, whether it is **MONEYworks**, the media, or you as investment managers or portfolio managers. If you are serious about price-to-earnings ratios and other financial ratios, you must realise that underlying that is the management and control of a company. If those are not in place, then the company’s performance is not going to be sustained.”