Speech by Gerald Santing – Managing Director, Markets

Dubai Financial Services Authority (DFSA)

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Ladies and Gentlemen,

With 2010 coming to a close I am sure that most of you had not put a presentation about securities lending regulation on your seasonal wish list. Nevertheless, it is good to see so many of you in attendance and I would like to thank the organisers of this event for inviting me and providing me with an opportunity to speak to you on behalf of the Dubai Financial Services Authority.

I would like to share with you some of my thoughts on the drive for transparency that is currently underway in the different segments of our financial markets. It is a very interesting time to be a regulator and to be able to apply my experience from the commercial side of the banking industry and the Dutch regulator to the big questions that will need to be answered. It is also an interesting time for the Middle East financial services industry: How will these changes in developed markets impact on the requirement to make changes to its own laws and rules?

The message from the G-20 communiqué of September 2009 is clear:

Major failures of regulation and supervision, plus reckless and irresponsible risk taking by banks and other financial institutions, created dangerous financial fragilities that contributed significantly to the current crisis. A return to the excessive risk taking prevalent in some countries before the crisis is not an option.

This bold statement only marked the start of the process igniting many hours spent tweaking, drafting and consulting on the final regulation. But it is clear that the political appetite is very strong. The train of new regulation has left the station. It is just not entirely sure what the journey will be like, nor which station will be next. The over-the-counter securities, derivatives and commodity markets will be under substantial pressure to create more transparency. The securities lending industry will not be immune to some of the proposed changes, as evidenced by recent actions from the Basel Committee on Banking Supervision and the passing of the Dodd-Frank Act in the U.S.

The big questions will now also reach markets that were previously unregulated or left to self-regulate: As said, the Dodd-Frank Act was passed in the U.S. Senate in July of this year; The Japanese parliament approved derivatives legislation to create more oversight of OTC markets; and, the E.U Commission launched its consultation of OTC derivatives regulation. EU regulation for hedge funds should come into effect in 2011.

In the next few minutes I will share with you what initiatives the DFSA has taken in the recent past to address some of these risks; and, what specific developments are underway in the U.A.E. I will also attempt to examine how your industry may be impacted by the introduction of future regulation.

DFSA initiatives

The Dubai Financial Services Authority, or DFSA, is the independent integrated financial services regulator of the Dubai International Financial Centre. The DIFC is a 110 acre purpose built onshore financial free zone in the Emirate of Dubai.

It is tax free and no foreign ownership restrictions apply. Currently DFSA supervises a total of 253 Authorised Firms. From full banking activities and re-insurance to securities brokerage, custodians and exchanges. Auditors and lawyers incorporated in the DIFC must register with the DFSA and are required to have a money laundering reporting as well as a resident compliance officer.

The federal commercial and civil laws have been disapplied and replaced by its own legislation and regulation. It is a common law jurisdiction with its own judicial authority.

The DIFC's civil laws include a companies law, insolvency law and various laws governing financial services, The DFSA rulebook include rules for conduct and prudential requirements. For example, the insolvency law provides for finality and netting of transactions and avoids the 'cherry picking' of certain contracts, derivatives or otherwise, over others.

To highlight some of the applicable legal provision for securities lending, the DFSA rules:

- Requires the Authorised Firm to make a suitable assessment of the risk profile of its counterparties and have consistent and robust methodology to measure its credit risk. These and other elements regarding risk control, measurement, monitoring and mitigation should be part of an overall credit risk policy that will require DFSA approval (PIB A.4.2);
- Allows operators of investment funds to enter into stock lending or borrowing arrangement, as long as they are collateralized. (CIR 10.5.6); and,
- Require an Authorised Firm in its trading book or elsewhere to re-calculate the exposure on a daily basis and adjust the collateral to take account of this change (PIB A1.4.1)

At the end of 2007 the DFSA introduced a hedge fund Code of Conduct. It aims to address operational and conduct of business issues for hedge funds. At the time it was aligned to guidance from the Alternative Investment Management Association and the Hedge Fund Working Group, and sought to introduce certain principles for hedge funds licensed by the DFSA. It should be considered as guidance to other legal obligations a firm may hold under various DIFC and DFSA administered laws.

At the end of 2008 an equity derivatives market was established by NASDAQ Dubai in the DIFC under a licence from the DFSA. A first in the region. The legal certainty of derivatives contracts concluded under DIFC Law, over-the-counter or exchange traded, in combination with robust insolvency law and access to the DIFC independent court system for commercial dispute resolution, provide solid building blocks for derivatives trading.

This year the DFSA finalised a revision of its regulatory regime for investment funds in the DIFC. This was done in conjunction with the industry participants. It was the fund and asset managers, as well as advisers that were asked to provide feedback and come up with recommendations to make the regime more competitive. It is a strong example of where the DFSA seeks to avoid regulatory burden whilst at the same time safeguarding the capital markets it regulates.

Next year will prove to be very challenging with the plethora of changes to regulation in the developed markets leading the way. In 2010 among other initiatives the DFSA aims to conclude a revision of its securities offering rules, review its transaction reporting requirement and market conduct rules.

Securities lending industry impact

Over the course of 2007 and 2008, at the height of the credit crisis, many restrictions were imposed on short-selling of financial securities. Some jurisdictions introduced very restrictive measures banning short-sales altogether; other jurisdictions only limited the position size, while many markets did not impose any restrictions at all.

At the height of the credit crisis securities regulators around the world have also been criticised for continuing to allow short-selling. Security lenders were some times swept up in this criticism. The scrutiny short-sellers have been under recently is personally fascinating. The debate rarely differentiates between the cleansing effect on over-valuation on one side and the destructive manifestation when it causes distrust in a bank's credibility, on the other. Are we listening to the canary in the coal mine or looking at the barbarians at the gate? Let's look at a few examples.

When Lehman defaulted on its obligations after that infamous Friday night of September 2008, the DIFC and UAE markets were the first of global markets to open and digest the impact of this catastrophic event. Sundays are the first trading day of the week in the U.A.E. the DFSA decided not to impose restrictions on short-sales, but instead to introduce a reporting obligation on gross short positions. Each trading participant now would report this to the exchange as the frontline supervisor of the market with an aggregate report by the exchange to the DFSA. This measure is indicative of every regulators need to obtain the factual intelligence on arising risks before introducing new regulation with far reaching consequences.

The need to arrange for proper settlement of transactions in the DIFC was already in place under the exchanges' business rules. Under a rolling settlement cycle this effectively banned naked short sales across trading days. Covered short-sales have always been allowed and remain unrestricted under DFSA rules.

Interestingly some of the restrictions on short-sales were already introduced in the U.S. early on in 2008. It did not prevent large day-to-day price moves and the subsequent demise of financial institutions. It is a reminder that regulation is not a short-cut to reducing the duration or magnitude of periods of high volatility in the markets.

A second example is the recent sovereign debt situation of Greece when it was allegedly under fire earlier this year from short-sellers. The question is whether this caused detriment to the credibility of Greece as a debtor, or whether it was the final push needed for the E.U. to take action on a member state's approach to budget deficit and public spending. The canary in the coal mine or barbarians at the gate? It is likely this debate is far from over.

An example of securities lenders being criticised comes from my personal experience. In 2006 at the early stages of the takeover battle for Dutch ABN Amro a simple letter by a 1% hedge fund shareholder was enough to ignite the battle for this longstanding bank. The letter suggested the break-up of the bank and the shareholding met the threshold for the AGM. Around that time the takeover of Euronext and Deutsche Boerse was surrounded by similar shareholder activism. This behaviour also triggered a discussion on the responsible role pension funds and other asset managers should take when entering into lending agreements.

Apart from market conduct issues, there is even more pressure to increase the current prudential requirements for banks and other participants. The reassessment of counterparty risk is an issue that will be addressed in Basel III. It is a debate that DFSA is following and will adopt to in due course.

The argument and legislation in the U.S. and E.U. for a more prominent role for central counterparties in the clearing of swaps is tempting, but in my view could create concentration risk which itself would need to be mitigated. Now that we have discovered that the 'too big to fail' rule no longer applies, does that then not imply that only a lender of last resort could run such clearing houses.

Moving all OTC derivatives on exchange will require significant additional collateral. A recent report commissioned by the World Federation of Exchanges estimated that around USD 2 trillion will be needed. In the short term, and I am quoting here, the effect is closer to USD 240 Billion between the top 14 dealers. The mandatory clearing can also cause unwanted cost increases and limit the flexibility that OTC swaps create. It is no surprise that this early desire has ended up differently in proposed legislation in the E.U. and U.S.

Developments in the Dubai and the Middle East

Let me now share with you some recent developments in the DIFC and outside of its jurisdictional boundaries in the U.A.E.

The U.A.E. was upgraded earlier this year by index provider FTSE to the category Emerging Market 2. This re-assessment was applauded by local markets with a rise in securities prices, and with it the hope arose that MSCI would do the same. An active market for short selling and securities lending represent two of the six criteria required by MSCI to gain 'emerging market' rather than 'frontier market' status. This combination would aid capital flows into the region, as well as increasing price transparency and liquidity. MSCI's last index rebalance was just recently and there was no change to the status of the U.A.E.

Settlement arrangements for exchange listed and traded securities on most GCC exchanges are typically related to the central securities depository. Although global custodians play an important part in the settlement process, legal and beneficial title is not separated. Lending for these securities is only possible through an exchange transaction or by internal group lending arrangements. Book transfers at the CSD are generally not allowed. The pre-validation method for sell side transactions make it a pre-requisite to have the securities in the trading account before entering orders. This operational constraint makes securities lending both costly and inefficient. However, at the same time technically possible.

The legal impossibility is defined by the prohibition upheld by local regulators with regards to short-selling. This is demonstrated by anecdotal examples how the prohibition to sell short can have a significant impact on the ability of corporations to raise capital. Let me give you an example.

A large UAE-exchange listed issuer saw the cost for their convertible bonds rise when they were unable to hedge the convertible bond position by selling the equity short. This bond was effectively priced like a corporate not a convertible, with the equity option given away for free.

Significant regulatory changes in one jurisdiction can also bring about increased and unwanted attention to other jurisdictions. Only a few months ago in the U.K., the proposed increase in taxation of profits for banks and the scrutiny of bonus structure and levels was said to create a flight of many hedge funds, proprietary firms and banks alike. It is interesting to note that a large U.K. brokerage firm, which offered its traders the possibility to move from London to any jurisdiction of their liking on the back of pending banking taxation, has not received any such interest.

The important question for a nascent jurisdiction like the DIFC and a regulator like the DFSA is to what other regulatory jurisdictions of reputable standard do you benchmark yourself against? The DIFC is aiming to bridge the gap between Asian financial centers on one side, and New York and London on the other. Best international practice: yes and at all times! But this can equally be found in emerging markets like Singapore for oil derivatives, Malaysia for Islamic finance, as well as developed markets like London for equity listing requirements.

Certain convergence to standardisation in the region is also under way for Islamic finance products: For Debentures like Sukuk, swaps like Ijara, and commodity contracts like Murabaha. The International Swaps and Derivatives Association, the International Islamic Financial Market in Bahrain and the DIFC Authority have been very active in this regard. NASDAQ Dubai, as a DIFC licensed exchange and clearing house, draws attention as the exchange with the largest capitalisation in Sukuk. The offer of securities for these Sukuk was made under the DFSA Rules and subsequently provided with the required no-objection to list on the exchange.

Conclusion/Final words

To conclude my observations, let me remind you of one of the purposes of our financial markets. Markets supply a public good and protecting the integrity and efficiency of those markets is in the interest of the public. The inability for investors and issuers, consumers or producers to 'discover' a price with integrity negatively affects their ability to raise capital, to transfer risk, to plan cash flows and will adversely affect economies as a whole.

Transparency is key in building integrity. It is not correct however to treat all markets the same and impose identical transparency requirements on all. There is no one-size-fits-all model to all markets and participants. Equities are not commodity derivatives; OTC Credit Default Swaps are not retail exchange traded equity options. Post-transaction reporting is already accepted in many markets, both on and off exchange, but disclosing pre-transaction information of OTC transactions could have an arguably adverse effect on the parties involved.

Liberalisation of markets has created significant wealth for many. However, a free market was never meant to be a free licence to take whatever you can get, however you can get it.

Capital markets and exchanges now admit members and their clients from across the globe. This has increased the pressure on regulators to harmonise their requirements, and to place greater reliance on home country supervision in order to reduce the cost of doing business internationally. In other words, the investment public is no longer confined to the population of the home state, but includes investors from around the globe. This requires a shift in regulatory approach. It also warrants a new look across firms, across markets and across jurisdictions. The words 'co-operation' and 'information sharing' are heard more frequently and the realisation is sinking in that the recent global loss in public wealth and welfare requires a more global regulatory solution and joint approach. To me, this implies that any gaps in the regulatory system that need to be closed in order to ensure effective regulation should be coordinated at an international, as opposed to, national level.

This liberalisation and interconnectedness has been developing over the course of decades and came to a grinding halt for a brief moment in 2008 with a subsequent reliance on central banks and governments to be more than just the lender of last resort. They have become the risk taker of last resort.

To contribute, learn and share information, the DFSA is actively participating in various regional and international fora: From the regulatory taskforce that advises the G-20 on the optimal way forward in OTC derivatives markets to the Financial Stability Board and the recent Basel III Committee. There is no other way for us as the DIFC exchanges and Authorised Firms are both regional and global in nature.

As to the form such change should take, the DFSA has the relative advantage of being a regulator to securities markets in a young financial centre: The size of the prudential risks present elsewhere is not as apparent in the DIFC. It also presents us with a challenge to try and eliminate the occurrence of regulatory arbitrage and at the same time giving DIFC emerging capital markets room to grow: What do we want to change? What appetite do we have for such change? And what form should this take, whilst the lack of transparency into the OTC markets until now obfuscated a full understanding of the risk. Perhaps comparable to the allegory of Plato's cave.

Consider a group of people, a long time ago living chained to the wall of a cave all of their lives, facing a blank wall. The people watch shadows projected on the wall by things passing in front of a fire behind them, and begin to ascribe forms to these shadows. The shadows are as close as the prisoners get to viewing reality. Plato compares the philosopher to a prisoner freed from the cave who comes to understand that the shadows on the wall are not reality at all, as he can perceive the true form of reality rather than the mere shadows seen by the prisoners. Although then the allegory of the cave is an attempt to explain the philosopher's place in society, perhaps we can now see this as an illustration of the combined role industry practitioners, regulators and Central Banks should take to understand the reality of bringing transparency to our markets. Do we at all times understand the complete reality of risks we are looking at?

I am convinced that the drive for transparency in financial markets is here to stay. I wish us all the wisdom, ingenuity and prudence that comes with defining and implementing such change. Thank you for your attention.