

Regional e-FX perspective on the Middle East

The Middle East region presents a mixed picture of accelerating growth in technology but slower development in product offerings. Richard Willsher investigates.



The Middle East region needs careful definition. The Arabian peninsula provides a useful guide, as it includes the Kingdom of Saudi Arabia and the Gulf states of the United Arab Emirates, Qatar, Bahrain, Oman and Kuwait. Lebanon and Jordan fall within our definition. We can effectively exclude Syria, Iraq and Iran from our e-forex market for reasons of conflict and sanctions, while further north Turkey's geographic location, economic and trade dynamics set it apart and beyond the Middle East region. Using this

as our working map includes a patchwork of countries moving at different speeds for a variety of different reasons though a unifying theme is the increasing growth of improved communications infrastructure and the inexorable spread of e-trading trading technology.

NEW TRADING AND INVESTMENT OPPORTUNITIES

Dubai and to a lesser extent Abu Dhabi lead the region simply because of their commitment to investing in infrastructure, building financial

centres to attract, among others, FX market players and their business and diversifying their economies. Significantly they are perceived as regional safe havens and places where corporates, institutions and retail traders can get their business done effectively.

"The UAE is turning into a regional hub for many multinational customers," explains Zul Butt Citi Group's Head of Markets Middle East, Pakistan & Egypt. "Most flows are either investment or trade related though there are plenty

of individuals who are interested in more speculative use of FX."

His colleague Yi Han Global product manager for Citi FX Pulse corporate platform adds, "It is increasingly clear to us that international businesses are using Dubai as a time zone base. We see a lot of corporate treasury visualisation occurring now. We are helping them manage their exposures not just for the Middle East but for the Middle East North Africa (MENA) region as a whole."



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There is a need for dealing between major G7 currencies and also local currency exposures in Africa."

This increasing role also spreads eastwards. "There are a lot of FX trading opportunities; Dubai has become a hub for FX trading," says Flextrade's Mumbai based Vice President – Business Development Vishal Kapadia. "The market is very easy to access for the G7 currencies and it is very easy to open up a business in Dubai. Dubai has become a regional hub for setting up FX trading shops, for example for those in other Middle Eastern countries and Pakistan and India who wish to trade but who cannot do so from their home territory for regulatory reasons. This is likely to increase as political situations across the region

means that people are moving their money to Dubai."

Meanwhile significant changes in the local gulf market are presenting new trading and investment opportunities according to Citi's Zul Butt, "In the past when we spoke of the GCC (Gulf Co-operation Council)' countries it was often oil related business, however if you look at the UAE now, only 36% of the GDP is oil related. We are seeing a tremendous amount of diversification happening in these economies. Governments have focused on developing retail, construction, leisure, financial services etc. Moreover there is also a large number of ex-patriot workers in the region. This has altered the nature of demand for FX services."

Furthermore, in Abu Dhabi, NBAD's Andrew Baxter, Managing Director & Global Head of E-Commerce highlights a variety of new or potential

business streams. "Regional equity markets are opening up opportunities for international investors. From June 16th international investors can own Saudi equities directly via qualified foreign investor (QFI) status. Saudi Arabia is the largest equity market in GCC accounting for 80% of market capitalisation of the region, roughly \$560bn."

He adds that Qatar and the UAE were recently upgraded to MSCI Emerging Market status, providing further catalysts and inflows and that the UAE market is becoming increasingly sophisticated with short selling via authorised market makers now permitted. In the third



Yi Han

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1. The Gulf Co-operation Council states are: Bahrain, Kuwait, Oman, Qatar, Saudi Arabia, and the United Arab Emirates.

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quarter of 2015 Nasdaq Dubai is planning the launch of single stock future.

"Whilst individually these may not drive huge FX moves, there will certainly be cross border FX flows and opportunities generated," Baxter concludes.

Meanwhile from an ECN point of view, 360T's Regional Sales Manager - Middle East and Africa, Alex Johnson says that beyond the UAE the markets to mention are Qatar and Saudi Arabia. "Particularly with everything that's going on in Qatar with the World Cup and the infrastructure projects that are happening there. They have been slow to adopt and are behind the UAE but I see these as the next big growth markets. Specifically in Saudi Arabia a lot of the expats have gone and the banks are being run by young Saudis. They are looking for modern systems, which benefits us, whereas the previous generation who had been

doing things the same way for 25 years were not so quick to embrace change," he says.

In addition to this Thomson Reuters' Global Head of Transactional Sales, Jim Kwiatkowski, adds that the introduction of e-FX platforms in the region is providing local firms with unprecedented access to both international and regional liquidity and is moving reliance away from local banks. "We are also witnessing a paradigm shift in sell side institutions as they increase the sophistication of their infrastructure to take on the demands of being a local liquidity provider in a more mature market. There is a great demand for affordable technological solutions that allow smaller regional banks to weigh up to their international counterparts by offering support for things like centralised branch requirements, auto-hedging outside working hours and distributing pricing via multiple channels," he states.

However 360T's Alex Johnson adds a note of caution. While volumes have increased in the FX spot market, other business streams have taken a backward step. "One big change is that prop trading is down from what it was a couple of years ago. Some of the structured or more complex deals that people were talking about a couple of years ago have either reduced or disappeared. This is a bit of a global phenomenon with regulation such as Dodd Frank and EMIR coming in. In a sentence I would say that the Middle East has gone back to basics."

BUY-SIDE REQUIREMENTS

If corporates and institutions may once have seemed wedded to their local banks and perhaps to voice trading this has now become virtually a thing of the past. The digital trading revolution has taken over and local banks have had to catch up.

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Andrew Baxter

"The secure presence of relationship trading as well as secure execution transaction capabilities have always been so important to the buy-side in this region," says Jim Kwiatkowski. "With the introduction of electronic trading, buy-side requirements have evolved to also prioritise transparency of pricing, proof of best execution and growing internal regulatory requirements. It is audit requirements that have spurred on many larger corporates to adopt electronic channels as they can benefit from the full workflow solutions that are then provided."

From his camp Alex Johnson agrees, "Where there were once a lot of voice brokers, this is no longer the case. Buy side clients used to prefer to speak with their house banks but I have a number of corporate clients that have told me that their auditors have told them that they have to put in 360T, otherwise they will have to highlight this in their auditor's report. Most of the big firms are forced to deal through a multibank environment but



Alex Johnson

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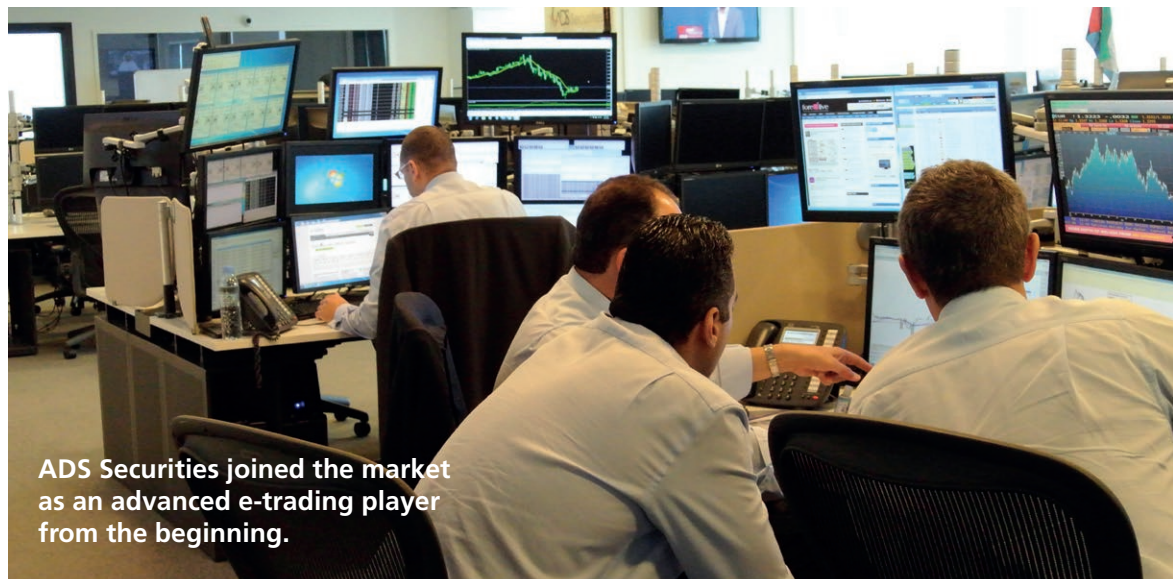
it is worth saying however that different e-solutions suit different clients. A large multinational with a variety of banking relationships is better off using a multibank system. A smaller local corporate with one or two banking relationships may be better off dealing with a single bank system."

Providing a regional bank's point of view, NBAD's Andrew Baxter is candid. "Until recently the majority of regional banks and corporates preferred to transact their FX needs via voice and/or directly via the Reuters Dealing platform, this was particularly true when it came to the GCC currencies. This situation changed dramatically on the corporate side over the past few years, with most now using platforms for all their vanilla FX requirements. While Reuters Dealing and brokers still retain the bulk of regional bank FX flows, there is a growing shift towards utilising multi-dealer platforms for FX needs."

BROADENING SERVICES

And it is on the basis of an increasingly broad range of services that the battle for clients is being won and lost. Merely executing transactions is not enough to retain their interest. Citi's Zul Butt succinctly summarises the position, "Simple spot FX is not even a business proposition any more," he says. "Everyone can provide it. It is really about pre- and post-trade services."

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ADS Securities joined the market as an advanced e-trading player from the beginning.

His colleague Yi Han explains, "Many corporate treasurers are highly sophisticated financial people with backgrounds in finance. In terms of pre-trade they are looking for research, analysis and information to help with their dealing or hedging decisions. They are looking for more granular information in relation to particular markets. And they are looking for more sophisticated products beyond spot FX. They are looking for a high degree of efficiency in reporting. They ask time and time again for post trade capabilities, straight through processing (STP) and information flow to their enterprise resource planning (ERP) and treasury management systems. They are also looking at risk management and cash flow management and beyond this to balance sheet management."

Thomson Reuter's Jim Kwiatkowski says that e-FX solutions are enabling regional FX providers to step up and start providing streaming liquidity to their clients, via either single or multi-bank portals.

He adds, "They are now really able to challenge the international banks that have otherwise been leading the way in this region. As the FX market as a whole has seen a shift in focus from a margin business to a volume business, regional banks now want to take advantage of the efficiencies electronic trading can bring. We are seeing them establishing trading desks that act less and less like an execution desk and more and more like a risk management desk having upgraded their infrastructure to support this."

GROWTH OF RETAIL FX

Yet it is perhaps in the retail theatre that pre- and post-trade services come into their own to the fullest extent, because retail investors do not have ERP and other internal systems. Moreover it is retail trading where the most growth and activity is evidenced in the Middle East right now. It is also the arena where trading using mobile technology is most advanced.

"Every company is trying to improve the services they offer," says Ahmad Khatib CEO at specialist retail broker Amana Capital. "They are improving the types of reports and analysis they offer to clients. Better educational support. Updates through mobile devices and there is lot of innovation in mobile devices and this is improving the services we can

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offer. There is small pick up in more sophisticated products but it is very small as compared to the spot FX market."

Khatib goes on to explain that voice trading is no longer significant to retail traders. Yet he adds that people want to know whom they are dealing with. "They want to know who you are and what your company can do but when it comes to executing trades they are doing so through e-platforms on mobile devices. This is something we pay a lot of attention to. Our people are very accessible to clients. They can meet them and interact with them on social media and so forth, this makes a big difference."

In the Middle East as elsewhere in the world MetaTrader 4 is the dominant technology in use



Jim Kwiatkowski

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in the retail sector. Flextrade's Vishal Kapadia says that traders look for things like technical indicators, buy-sell signals, charting and analysis.

"Many of them are not very sophisticated. Some of them are making good returns though the risks they are taking may be quite large. Retail FX is marketed quite aggressively. There are a lot of events and conferences. Clients are given a platform to trade on and a credit limit of, say \$2500 to start trading with."

However he adds that some retail fingers have been burnt. "The Swiss Franc disengagement from the Euro in January produced a lot of losses among traders in Dubai – Alpari and its clients was perhaps the best-known case. Clients have become more conservative after that and some of the brokers are having a tough time getting people to trade. They are facing challenging times and it is only matter of time before some of them close or are taken over. Many clients are now looking



Ahmad Khatib

to work with brokers or houses that are well regulated by a competent authority, so many of the brokers are now trying to get themselves regulated."

Amana's Ahmad Khatib agrees with this and his firm has been forthright in making sure the entities in its group are well regulated by respected regulators such as London's FCA.

Abu Dhabi based ADS Securities is another leading business offering both Institutional and Retail FX services that has joined the market as an advanced e-trading player from the beginning.

"At ADS Securities we have developed and launched our own platform," says Iskandar Najjar ADS' managing director for the MENA region. "The UAE

is in an almost unique position in that the region has the ability to invest in technology. It is also true to say that the market is looking for regional suppliers, companies that really understand how to develop the products and services that traders want. The UAE was the first regional market to introduce a derivatives exchange and the investment culture is developing all the time but Saudi Arabia and Kuwait for example, are increasing in sophistication. With the work that ADS is doing it is fair to say that the FX sector is expanding fast and is fully supported. We are currently working towards introducing a range of new products such as futures, options and forwards as well as an expanded range of contracts for differences (CFDs). With all these products we provide a very high level of customer support and education. Again the main developments will be mobile trading and an increased range of products."

SHARIAH PRODUCTS

Shariah compliant products represent Islamic regulation of financial services and they are in demand in the retail sector particularly.

"There is always demand for Shariah compliant products but it is a debatable issue and the clearer it gets the better it is for clients and those who supply Shariah products," says Khatib. "But Shariah compliant FX has

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not reached the level of Shariah compliant banking for example, where it is official and widely accepted. We hope that work on the products will continue and help improve the way clients view such products."

While NBAD is not involved in retail products Andrew Baxter does experience demand for Shariah products though they pose particular challenges. "The nature of Shariah finance in the region and the lack of a standard approach to documentation provides significant challenges to implementing scalable e-commerce solutions," he says. "Whilst cash products



Iskandar Najjar

(including spot) can be traded conventionally, all other types of trades require a considerable amount of documentation to be in place. We are beginning to see attempts to automate



The unknown factor in the Middle East is the geo-politics

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commodity Murabahah transactions but there is still work to be done before Shariah compliant FX can really take off. The Islamic market globally, and specifically e-commerce would benefit immensely from a standard approach to documentation such as an Islamic ISDA."

THE FUTURE

Whether Shariah will become one of the growth areas for the future remains to be seen. It could happen. But what is not debatable is the inevitability of the future dominance of e-platforms to transact FX business in the Middle East region.

Alex Johnson says, "As an indication I am seeing the two and three tier banks in the Middle East looking at getting e-commerce people on board. I'm having conversations with some of these guys about white-labelling our platform. Where clients are demanding that these banks have an e-channel, the smart banks are looking at it. In fact banks that ignore e-FX do so at their peril. If you want to be a serious player in the corporate and institutional FX business you have to adopt it. Clients will say to potential new banks, if you can't price me on the channel where I want to be priced there isn't much point in us meeting. So I think the market will continue to grow and filter down to the smaller banks and corporates. And also people

"Dubai has become a regional hub for setting up FX trading shops..."

are much more knowledgeable about the e-channel than they used to be."

Jim Kwiatkowski summarises the factors that he thinks will shape the future of e-FX trading in the Middle East from a Thomson Reuters' standpoint. "Connectivity, secured lines, regulatory reporting and the need for globalisation are factors likely to shape e-FX across the region. We see more local players becoming regional and then eventually international players, leveraging their trading relationships with other international providers to offset risk when required. We will see Middle Eastern banks establishing themselves as the place to go for GCC pricing as well as challenging international banks in the G10 space. Continued growth from the buy-side plus an increased demand for Middle Eastern liquidity due to foreign direct investment will be a factor."

So while the Middle East has not been a leader in e-FX among the world's regions, it looks likely to be one of growth over the coming years. Dubai is likely to spearhead this growth as it cements its position as a time zone hub, positioned for trade with Asia, European and also early-day US.



Vishal Kapadia

Regulation has already had a significant role to play and this is likely to continue, as with every other region of the world.

The unknown factor in the Middle East is the geo-politics. Will the spread of Islamic fundamentalism affect e-FX markets? Will Iraq and Syria take their places on the global FX map in the future? And will Iran's huge wealth translate directly into e-FX business in the foreseeable future, following its apparent rapprochement with the US? These are unknowns but as it seems likely that there will be significant growth in international trade at some stage and that this will produce an interest in engaging with the global FX market in one way or another, then there will surely be further substantial growth in e-FX trading; the big question is, when?