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ABSOLUTE STABILITY

Philip Thorpe of Qatar Financial Centre Regulatory Authority

Dubai Technology and Media Free Zone Authority

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COVER INTERVIEW

No nonsense

The winds of change may be raging through the Middle East and North Africa, but one place at the heart of the region is managing to attract those in search of calm and that place is the peninsula of Qatar. Phillip Thorpe, the man at the helm of the Qatar Financial Centre Regulatory Authority tells *Banker Middle East*'s readers how to avoid the financial reefs

In early 2005, Qatar established the Qatar Financial Centre (QFC) and around the same time, set up the Qatar Financial Centre Regulatory Authority (QFCRA) to play the policeman's role. The QFCRA is an independent regulatory body established by Article 8 of the QFC Law. The QFC was created by QFC Law No.(7) of Qatar and has been open for business since 1 May 2005.

JP Morgan got its licence in January 2011. JP Morgan's branch in the QFC is a PIIB Prudential Category 4 firm and it is authorised to arrange credit facilities, deals in investments, and the provision of custody services, as well as advising on investments. The bank's move there brings the total number of firms licensed at the QFC to 128.

JP Morgan was soon joined by Concordia Capital (also a Category 4) and Takaful International Company, a direct insurer which is authorised to provide general Takaful products on a corporate basis.

Phillip Thorpe is the Chairman and Chief Executive Officer of the QFCRA. Thorpe began his career as a barrister and solicitor in New Zealand, before moving to Hong Kong to take on various senior posts with the Hong Kong Securities Commission. He was later appointed the CEO of the Hong Kong Futures Exchange. In 1989 he moved to London as CEO of the Association of Futures Brokers and Dealers, and subsequently became an Executive Director of the Securities and Futures Authority of the UK.

Following this post, he served as CEO to the London Commodity Exchange, Chief Executive of IMRO (the fund management regulator), and Managing Director of the then newly formed Financial Services Authority in the UK. More recently, Thorpe has held the post of Chief Executive of the Institute for Financial Markets (Washington DC) and the CEO of the Dubai Financial Services Authority.

The Regulatory Authority Board consists of Phillip Thorpe, Jean-Francois Lepetit, (the one-time Chairman of BNP Paribas Group's Market Risk Committee and current non-executive director of BNP Paribas), Robert O'Sullivan (who was once a senior vice president in the Bank Supervision Group of the Federal Reserve Bank of New York), Brian Quinn, (a former Executive Director, Supervision and Surveillance, and Acting Deputy Governor of the Bank of England) and Andrew Sheng, (who was the Chairman of the Hong Kong Securities and Futures Commission for seven years. He has also chaired the Technical Committee of IOSCO).

The QFCRA's website outlines what it stands for and what its beliefs are thus:

"To play a pivotal role in the development of a dynamic, innovative and stable financial services industry, which contributes to the economic and social wellbeing of Qatar

Our Beliefs

- Qatar's national interest is at the heart of what we do
- Regulation is a positive force
- We set and expect high standards
- Our people are the engine of our success"

Straight-talking Thorpe gave *Banker Middle East* a no-nonsense view of what the Regulatory Authority stands for.

What does the QFCRA think will be the key themes in banking regulation in the Middle East in 2011?

If we look at the GCC, the high oil price will drive most of the economies forward – delivering strong growth unlike many other parts of the world. This positive growth story will however bring with it risks as new participants will be attracted to these strong economies. As regulators our challenge will be to educate business and individual investors of the potential risks associated with the new opportunities presented, while balancing that role with the broader aim of expanding and widening the financial services sector and the products on offer.

Improving corporate governance also needs to be a continuing focus of regulatory attention in order to help drive these markets from their current frontier market status. Improved transparency within financial institutions, and within the government agencies overseeing the markets, and good rules consistently applied, will provide the foundation for greater investor confidence and growth of the markets.

> National interests invariably trump international cooperation when the theory of international cooperation is put to the test. It is no different in the MENA region.

What did we learn from 2010 from a regulatory perspective?

The lessons of 2010 are perhaps better seen as the lessons of the last three or four years, and sadly, they look very much like the lessons of various previous market collapses. These events consistently reinforce the need for effective regulation. Perhaps what has come through most clearly in 2010 is that actions by sovereign states as the 'lenders of last resort' , while well-intentioned to prevent market falls and further collapse, have allowed us to put off addressing the underlying issues – excessive borrowing, risk taking and the misalignment of participants' objectives and the wider economy's goals.

And already we are seeing signs that some in the industry would like to return to their old ways. Regulators need to focus attention on the basic problems. This means demanding absolute clarity regarding risk and reward, and a fundamental shift in reward expectations in the banking sector. It also means there must be a real disincentive for those engaging in the types of inappropriate behaviour that brought the markets to the edge of destruction. Those responsible for the failures must be investigated, prosecuted, and barred from the markets; enough is known about carrots, it's time for the sticks.

What, if anything, has the upheaval across the MENA region meant from a regulatory perspective?

It has increased the focus on monitoring and understanding risk. Having the necessary facts to understand where you have exposure and questioning whether it is appropriate.

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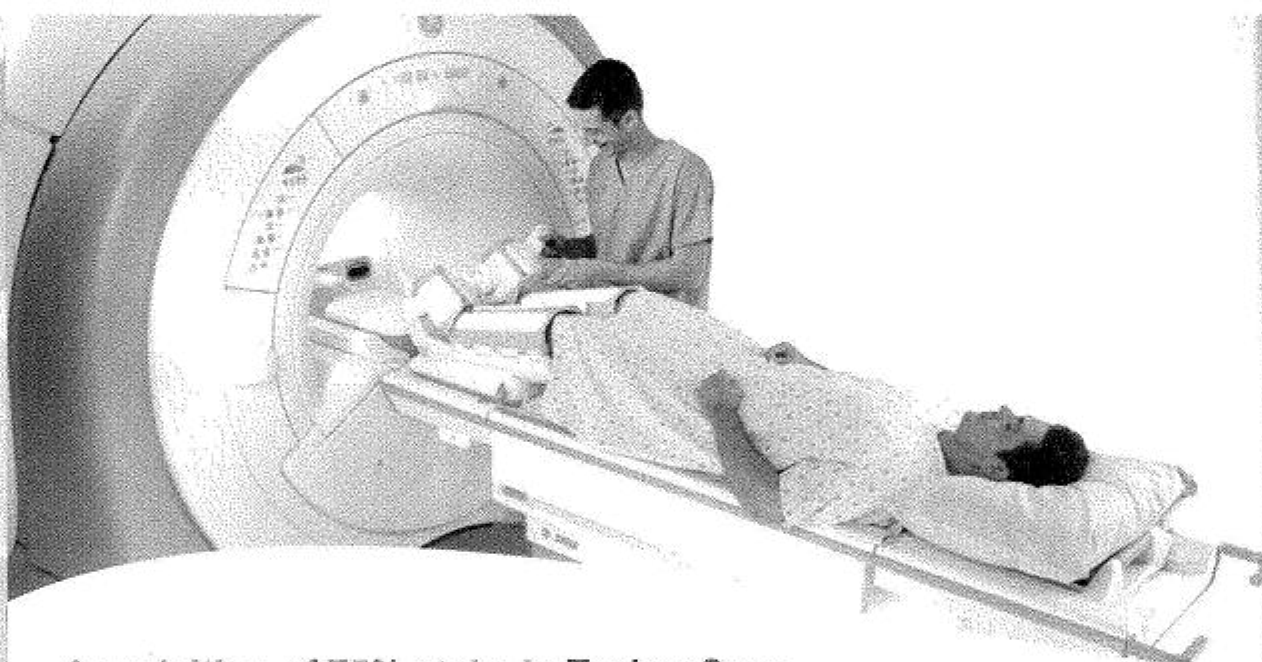

Acquisition of 75% stake in TechnoScan,

the largest chain of diagnostic and imaging centres in the Middle East

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Maritime Industrial Services
Regional leader in Oil & Gas construction services

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Liquidity has also returned to the forefront of our concerns. As markets have become dislocated and liquidity has dried up, the criticality of liquidity in the safe functioning of the markets has been clearly shown.

The upheaval has also emphasised the importance of collaboration between regulators to help understand the extent and nature of risk and to facilitate the coordination of actions. This is of course a lesson learned through previous crises, and the solutions remain elusive whenever we consider cross-border trades. National interests invariably trump international cooperation when the theory of international cooperation is put to the test. It is no different in the MENA region, and the differing degrees of development of the regions markets probably make the challenge of collaboration even greater. That said, there is a great deal of goodwill in our relations with regional regulators, and that provides a basis for some optimism.

enforced, and greater transparency may aid in understanding regulatory requirements.

A skills shortage in regulators and financial service firms is a further factor that is being exacerbated by the pace of growth in Qatar and similar markets, though we are seeing increasing provision of training, which will help in the medium term.

Finally, it is evident that many markets share a common inheritance of old laws that have been outpaced by developments in the marketplace, leaving some financial services activities poorly regulated, or in the worst case, not regulated at all. It is one area where collective cooperative action to draft new standard laws or codes might be advantageous. However the caution that must accompany that observation is that the pace of change, and the appetite for change, varies widely in the region, and it would be regrettable if we all had to travel at the pace of the slowest.

> Those responsible for the failures must be investigated, prosecuted, and barred from the markets; enough is known about carrots, it's time for the sticks.

Market volatility and the disruptions seen in the last two or three years also emphasised the importance of business continuity planning – making sure actionable plans are in place and tested. We have long required these plans, but there's nothing quite as useful as an actual event to show their strengths and weaknesses, and we are learning from that.

In the short term, any upheaval on the scale we have recently seen also distracts governments from addressing some of the fundamentals, such as the need for ongoing reform of the markets, and their laws, and their supporting regulatory and judicial structures – which as a consequence becomes further delayed. It is hoped that these overdue reforms will advance before too much more time is lost. Our rapidly expanding economy deserves, and needs, a secure, safe financial services environment.

Where are the biggest regulatory voids/gaps in banking regulation in the MENA region?

There is so much diversity amongst the markets of the region that it is difficult to provide a coherent answer to that question. Each market has its own challenges. But perhaps some themes are evident: transparency is a common problem, whether we are looking at the operations of the markets, public companies, or the actions of regulators. Consistency is a related point: it is difficult to be certain in many markets how regulations will be applied and

Does private equity/Islamic finance/the non-banking sector in the region require more regulation?

Many regulatory regimes in the region are still evolving, and have yet to provide for the plethora of new activities and products that have emerged over the last few years. Inevitably changes to regulations will follow, and in some instances, new laws will be needed to bring activities within the regulatory environment. This is a process that is not unique to the region, and we have the advantage of being able to look at how regulators in more developed markets have responded to these challenges, and to learn from those experiences.

Islamic finance is likely to be an area ripe for such regulatory development as private and institutional interest in Shari'ah products continues to grow. In Qatar we have been greatly aided in shaping our response to these developments by our membership of the leading standard setting bodies in Islamic finance and we have been actively monitoring the need for enhancing our own Islamic finance rulebook.

Is the era of light touch regulation over globally?

I don't think anyone wants to see more heavy handed regulation just for the sake of it, but we do have to remember the trade-offs that lay behind the development of those now-questioned light touch regimes. Lighter regulation has

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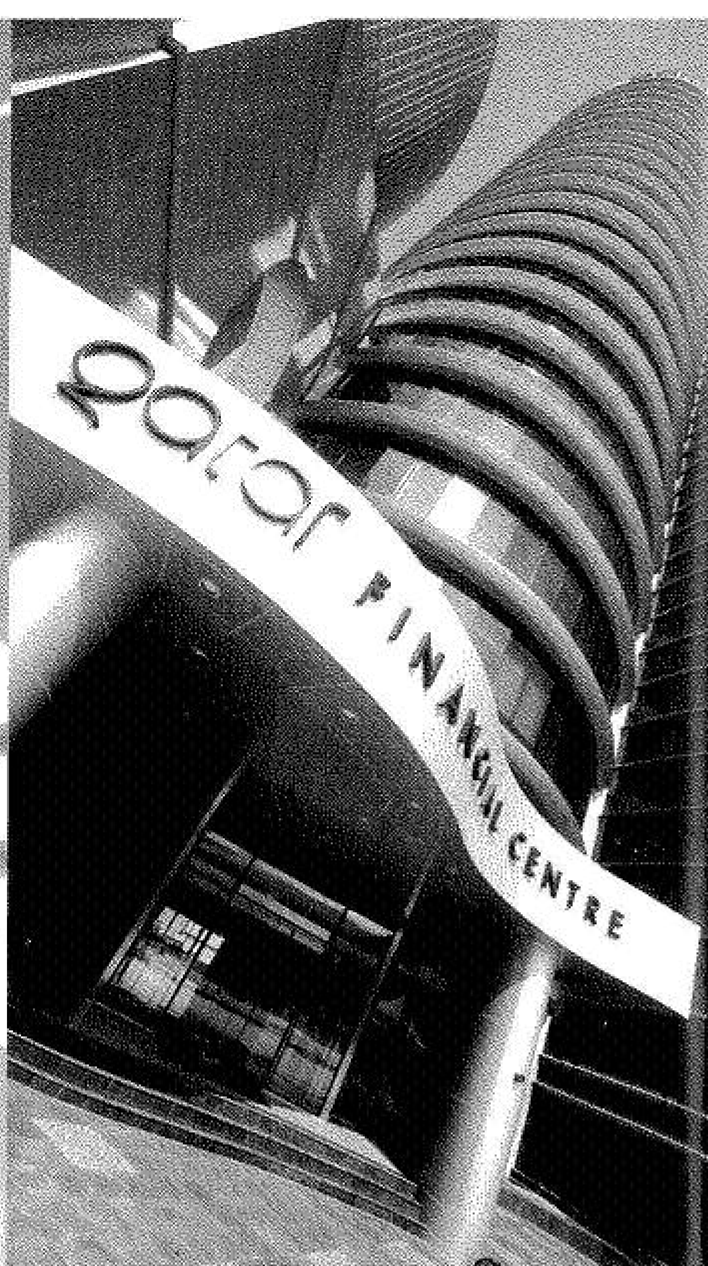
usually been associated with either markets with more self-contained risks (the concept of a 'professionals only' market) or effective self-regulation (which has few advocates these days) or a clear understanding that inappropriate behaviour will be met with strong disincentives, delivered through enforcement actions and prosecutions.

What we cannot have is a situation where there is light touch regulation and no or insignificant penalties when even those lighter rules are breached. What we must also be alert to is the fallacy that so-called professional markets are somehow ring-fenced from the wider financial markets: that has clearly been demonstrated as an unsafe assumption given the vast public funds that have had to be spent on the failures of sectors far removed from direct public participation. So I think it's safe to presume that calls for the maintenance of light touch regulation will be unattractive to regulators, and yes, more prescriptive regulation is inevitable.



What does Qatar offer banks that other regional and international financial centres do not?

Stability, and of course a growing economy with a very positive outlook for the medium and long term. Qatar has a vision that shows a commitment to high standards, transparency and accountability, and international indicators for these factors consistency show Qatar as a regional leader. Qatar offers an excellent platform to base a business in the region, as well as offering domestic opportunities in various growth sectors, particularly asset management and insurance.

> A skills shortage in regulators and financial service firms is a further factor that is being exacerbated by the pace of growth in Qatar and similar markets.

Do we need a Basel 4?

We need smart regulation. And yes, inasmuch as we need consistency across the major financial centres to prevent regulatory arbitrage, international standard setting goes some way towards achieving that. Is Basel 3 (or 4 ...) the complete answer? Clearly not. There is a great deal of regulatory reform for regulators to get to grips with of at least equal importance to new capital rules.

Does regulating bankers bonuses make any real difference?

I'd suggest it is more productive to step back and take a wider perspective. There needs to be a realignment of rewards right across financial services; the risk/reward equation is skewed, but yes, we have seen that most luridly in terms of employees receiving bonuses with little or no downside if losses are incurred. As many regulators are now demanding, boards must review what returns they want for the long term as well as the short term and adjust payouts accordingly.

However, my point is that the more important issue to address is investor or shareholder expectations. For as long as shareholders expect returns of 20 per cent on Main Street bank shares, we will inevitably see those banks engaging in risk-taking that is hard to reconcile with their risk management abilities and their core function in the financial system. A significant downward adjustment in return expectations is needed. When that occurs, bonuses will follow suit.

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Are there any areas of anti money laundering that you think need strengthening?

In Qatar, new laws and regulations have been implemented in the last 12 months and good progress is being made on spreading an understanding of the requirements and developing controls. This will be consolidated through a broad implementation plan now well under way. There is also a need to further strengthen resources and expertise, which is a common challenge in the region, but we believe the legal architecture is in good order.

Is a lack of common regulation in the region hindering the much-anticipated bout of banking consolidation?

Whilst this may be a contributing factor, I would not overstate its significance, as there is probably more similarity than difference when it comes to the fundamentals of the different regulatory regimes. There are other factors, including differing national priorities, which make cross-border consolidation more difficult. However the indications are more positive when looking at domestic consolidation; certainly in Qatar we are seeing progress.

products. I also hold the view that this development would be best seen in the context of exchange-traded derivatives, and am looking forward to seeing our own exchange (Qatar Exchange) bring forward its plans in this regard.

How will the banking landscape in Qatar change in view of the World Cup?

Perhaps the question should be how will the landscape of Doha change, to which the only answer is, 'dramatically'. And for the banking sector too, though perhaps more in terms of the potential volumes of business rather than in the shape of the industry's architecture. 2022 presents a significant opportunity particularly on the corporate side through the explosion of new project finance. The Minister of Finance has stated he estimates up to $170 billion will be invested in infrastructure and other projects in the period leading up to the World Cup. There is also expected to be considerable inward investment and we also see potential for significant development of the insurance market, as companies look to underwrite project exposure. It will undoubtedly be an exciting time for Qatar and the region. ■BME

> We cannot have is a situation where there is light touch regulation and no or insignificant penalties when even those lighter rules are breached.

What steps is the QFCRA taking to promote Islamic finance?

As a financial regulator we do not seek to promote any particular financial sector, rather we endeavour to ensure our regulations and rules are attractive to those looking to establish their businesses in the region, and reflect the high standards required by the Government. We also seek to ensure our processes are efficient, so that we can respond quickly to potential applicants and to changes in the marketplace. This approach has seen a consistent level of interest from Islamic finance firms and the establishment of some significant new entrants into that market.

Is the Middle East ready for derivatives?

Derivatives are already being used by some corporates, mainly in the shape of relatively plain vanilla debt, FX and commodity hedges. Derivatives have got a bad press over the last year or two given the part played by certain products in the financial crisis. But it would be unfortunate if all derivatives were viewed as problematic, and I certainly feel that the region's markets cannot properly develop without access to some of those