Link to Article

Complex Middle East Equation

Wealth management industry veteran Gary Dugan looks at the problems facing Dubai and its surrounding financial centres as oil price falls impacted investment as lax regulatory action is about to change

CASCADING OIL PRICES, among other factors, have had a catastrophic effect on efforts to implement asset protection strategies in the Middle East, with analysts and industry insiders taking the firm view that a "nightmare is waiting to happen".

Add to this the lacklustre approach by region's regulators in the past, and a dismal picture is emerging for wealth management in the area.

GARY DUGAN
Independent financial consultant

One man with his finger on the pulse is Gary Dugan, former CIO at both National Bank of Abu Dhabi and Emirates NBD in Dubai, who is now an independent financial consultant in the region.

Dugan sees the storm clouds gathering but is quietly optimistic that the long-term outlook, if handled correctly by industry professionals and regulators, will eventually see stability and growth.

He summed up the current situation by saying: "The key problem in the region is the intermingling of money that people have in their businesses and money in their portfolio. It has been very difficult to persuade clients to completely separate those two. Sheikhs and other highly wealthy people are well on the path to doing that, but in the more nascent market you will find that people still intermingle their day-to-day cash flow, working capital of their businesses with their investments. They can't really distinguish between the two, which means that they tend to keep things for a very short duration, leading to the bank balance being more than you really want and the bond portfolio more modest.

"You don't really get forward planning. We have only been a couple of years into an environment where the oil prices have been very low and there has been this real hardship in the region coping with an oil price below USD 50. The attitude in the past was there will always be more money coming next year, then they realised there would be no money next year, and probably no money the year after. They are still trying to get their heads around this negative cash flow and that

lends itself towards an investment that is very short dated, very cash orientated and only looking for enhancement of yield rather than looking for significant capital gain."

When asked if this was a nightmare scenario waiting to happen, Dugan replied: "Absolutely."

Dugan sees the investment proposition in the Middle East as a split between the onshore and offshore market, with onshore having developed significantly over the last ten years as investors move their positions from real estate and local equities coupled with a small bond portfolio to a substantial allocation of bonds that are highly leveraged.

"The onshore proposition is still very focused on the local asset markets but there is a big shift towards bonds and Sukuks. In the offshore market, people are still looking to use that international brokerage and so to a lesser extent maybe in the case in the past for alternative investments," Dugan said. "There are still people looking at some private equity, but that is less the case nowadays."

THE REGULATOR HAS ALREADY IDENTIFIED THE INSURANCE INDUSTRY AS A PROBLEM, AND I THINK THEY ARE GOING TO COME DOWN PRETTY HARD AS WE SEE REGULATIONS CHANGE OVER THE NEXT 12 MONTHS

Dugan believes the role of the region's regulators will be pivotal in pulling the wealth management industry back from the abyss that is perceived to be forming, citing the fact that now, after two years of paper shuffling and debate, a new dawn is on the horizon in regulatory terms to bring the region in line with global financial centres.

"The regulators are getting a much stronger handle on what they need to do. We have probably had one or two years of discussion and debate without any significant decisions being taken, but I think the decisions that will be taken over the next 12 months will bring Dubai up to the kind of standards that we have seen in other parts of the world, for good or for bad," Dugan said.

"The UK is much regulated and I have worked in Singapore, which is much regulated too. I don't think the new regulations will want to be significantly toned down from those kinds of regimes, because that's the level to which we have to aspire.

"The regulator has already identified the insurance industry as a problem, and I think they are going to come down pretty hard as we see regulations change over the next 12 months to virtually ban some of the very expensive products that were sold in the past and therefore insurance providers will have to change."

Dugan also sees a deepening of the influence of Shariah compliant products becoming a much more meaningful part of wealth management. "In the past, people paid lip service to it and even when we put tremendous propositions together, no one really sold it or seemed interested," Dugan said.

"I think the change has been in the institutional market in Saudi Arabia. There are a number of endowment funds that are being setup at the moment, all of them are Shariah compliant, and therefore you are finding a greater demand for Shariah compliant products. Once those products are created and find their way into the retail market, I think the Shariah compliant element to the market could easily double or triple its scale in the coming years." ■

The way ahead

INDUSTRY VETERAN GARY DUGAN sees a shifting of the wealth management landscape in the Middle East over the coming few years, as new regulations come into force and players in the game find their level amid new economic realities.

"I would expect to see a couple of major changes in the coming years. Private Banks have had the lion's share of the wealth, but there are more and more medium-sized players and more focus on smaller clients," Dugan said. "I think this will offer the growth opportunity, and a great margin opportunity. In terms of private banking, it will get more sophisticated, it will get more international.

"Many clients still say they want more international diversification, but they are still unfamiliar with the names and the concepts. One of these concepts is private debt, and because they don't see this in their own local market, they are running scared of it, yet this has been the biggest institutional game of the last five- to- seven years." ■