From ‘Frontier’ to ‘Emerging’
Kuwait opens up further to investors

Emma Almerzah
Head of Securities Services, Kuwait

Frankie Vaz
Regional Product Manager
Securities Services, MENA

Together we thrive
It’s a day that many have been working hard for. Despite the myriad challenges presented by the COVID-19 pandemic, Kuwait’s inclusion in the MSCI Emerging Markets index took place on November 30th, 2020. This report outlines the steps taken by key stakeholders responsible to set the conditions for such an achievement, and how investors are best-placed to take advantage of one of the most significant market milestones for Kuwait this decade.
That said, the small but wealthy nation has faced stronger economic headwinds in recent times than its neighbours in the Gulf Cooperation Council (GCC) countries, resulting in significant friction between government and parliament on whether to boost liquidity in its public finances through new debt laws.

With a new Emir now in place since September this year, there is renewed impetus to address the challenges of diversification, oil subsidy cuts and tax reforms that are needed to keep pace with GCC neighbours.

Doing so is by no means an easy task – petroleum still accounts for the majority of Kuwait’s GDP, and over 90% of its exports and government income¹. An over-sized public sector and relatively young population makes this rebalancing demographically difficult too.

Therefore, securing significant capital inflow from large private sector players is a priority in realigning the country’s economy and helping Kuwait face the future with confidence.

2 > Vision 2035 and financial market reform

At the heart of Kuwait’s ongoing mission to reform and diversify is its National Vision 2035.

Modelled similarly to those of its peers in other key MENAT markets, the Vision provides a framework for committing to Sustainable Development Goals that largely match those adopted by the UN in 2016 – though individual countries vary the speed and focus depending on their circumstances.

Kuwait’s Vision 2035 ambitions cover all aspects of the country’s future wellbeing - from repositioning its global status in trade and culture, to reforming the nation’s infrastructure, education and public sectors to ensure a diverse, healthy economy and sustainable quality of life for its population.

For Kuwait, Vision 2035 is a vital guiding light for reform, given the country’s imperative to restructure and open up further through a more streamlined and dynamic financial market. The Vision was updated in 2017 in a move to reduce the burden on the state to support these far-reaching targets, from 90 percent to 30-40 percent.

The balance is to be picked up by private sector participation as part of the wider ‘New Kuwait’ drive, which highlights a solid ambition to realise the country’s future status as a financial and cultural hub within 15 years.

International investor corporations are what Dr Sophie Olver-Ellis describes in her London School of Economics paper in January 2020 as key to “embedding Kuwait into the global economy, attracting 300 percent more Foreign Direct Investment (FDI) and raising more than 400 million KWD (£1.3 billion) from international corporations.”

For the investors, she adds, the specific focus is to attract interest in “strategically important industries such as information and communication technology, renewable energy, electricity and water, tourism, healthcare and education.”

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2 http://www.newkuwait.gov.kw/r1.aspx
4  http://eprints.lse.ac.uk/103198/1/Olver_Ellis_building_the_new_Kuwait_published.pdf
A number of key events have been pivotal over the past decade in making inclusion happen. Boursa Kuwait, the national exchange operator that took over the Kuwait Stock Exchange in April 2014, helped facilitate the path to technical improvements – such as supporting HSBC’s proposal for speedier account openings for investors. However, it was the establishment of the Capital Markets Authority (CMA) in 2010 with its reforming mandate to engage with Boursa Kuwait and the local CSD Kuwait Clearing Company (KCC) that has prepared it for Emerging Markets status and helped pave the way more comprehensively.

A structure of governance was agreed, and in 2016 the Market Development Project (MD) was initiated.

There was close cooperation with Boursa Kuwait to form a ‘market readiness’ team, and in 2017 the CMA obtained full membership of the International Organisation of Securities Commissions (IOSCO). This was followed by the go-live of MD’s first Phase later in 2017 and inclusion in the Emerging Markets Index by FTSE Russell in two tranches in September and December 2018, and subsequently by S&P Dow Jones in September 2019.
Launched in 2016, the MD project committed to four phases in the run-up to MSCI inclusion and beyond, scheduled to deliver on Phase 4 in 2022. Of the earliest reforms implemented in 2017, the settlement cycle was unified for both domestic and foreign investors to T+3 across the board. Corporate action dates covering Ex, Cum, Record and Payable were introduced in line with international standards.

Investors’ concerns over Asset Protection were addressed by the implementation of a Custodian Rejection facility in July 2017, allowing for trade rejections up to 12noon local time at T+2. A KCC-run Financial Collateral System replaced the Settlement Guarantee Fund, requiring custodian and brokers as well as KCC to have collateral in place. Finally, Boursa Kuwait made changes to tick sizes, price limits and closing auction times.

April 2018 saw the launch of ‘MD2’ — designed to introduce:
- Model 1 settlement for gross securities and gross funds
- Introduction of buy-in board and cash close-out process
- Late confirmation for rejected trades by custodians
- Premier, Main and Auction markets segmentation
- The introduction of a circuit-breaker mechanism
- An automated settlement process for special trades.

MD Phase 3 split into two stages, with the first being implemented in April 2019.
As well as restructuring the market to reflect changes to bylaws, the first stage changes that participants faced included:
- The introduction of stock lending and borrowing, and short selling
- The introduction of Real Estate Investment Trusts and mutual funds.

Second-stage developments due to be implemented include:
- BIS Model 2 Settlement (gross securities/net funds)
- Cash settlement, either through settlement banks or through the Central Bank of Kuwait
- Introducing a qualified brokers model
- Sub-account identification for omnibus accounts.

Some extra market developments outside the MD project remit have been adopted to enhance market flexibility in time for the MSCI upgrade. Crucially, omnibus accounts and same NIN crossing is now allowed for foreign investors. Additionally, an Over-The-Counter (OTC) trading platform was created in 2018 to allow trade in unlisted securities, including unlisted equities, corporate bonds and sukuk.

An Allocation Consolidation Module (ACM) account process went live in early November, allowing local brokers to execute block trades via an ACM account NIN and then allocate the trades to segregated investor accounts. The NIN should be opened by the local broker and custodians will not receive any reporting of the block trades prior to allocation. However, custodians will receive trade activity reporting from the KCC at segregated account level, post trade allocation.

A new settlement mechanism will be applied after inclusion, whereby settlement will be on a net basis. Netting allows flexible settlement on individual and institutional investors. This means that, if an investor executes both purchase and sale trades in the same trading session, they are not required to pay the full value of the purchase transaction, but rather the net amount of the purchase and sale trades. If the sale proceeds amount is higher than the purchase amount, the investor will receive the net amount from the KCC.
5 > MSCI and Kuwait — a deepening relationship

For Kuwait, reaching the milestone of inclusion as an Emerging Market has been the culmination of a long process of consultation with MSCI which began in June 2018. To date, the country has also been very highly weighted on MSCI’s Frontier Markets index.5

Pavlo Taranenko, Executive Director, Index Research at MSCI, explains: “We ran consultations with market participants for a year. The feedback was very positive, both about the market and the Market Development project. There was one specific caveat about omnibus accounts and crossing, where some clients felt they would be more confident if these structural issues were reformed, to help them better access the market. That was quickly addressed by Kuwait - within just two months.”

Kuwait, which is currently the largest frontier market in the MSCI FM and MSCI FM 100 indexes, is likely to have 21 constituents (7 Standard, 14 Small Cap) in the EM index. EM Passive trackers’ buying could lead to net inflows over USD2.7bn at the time of inclusion. In terms of size, Kuwait (0.58%) could be behind Qatar (0.79%) and Poland (0.70%) and ahead of UAE (0.55%) in MSCI EM.

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5 Slides for 30 Sept 2020 provided by MSCI at HSBC Kuwait webinar, Kuwait Upgrades To The Big League
The journey to Kuwait’s MSCI inclusion and beyond has also had vital input from Securities Services at HSBC.

The Bank is viewed as a working partner by many exchanges and intermediaries across MENAT, and has a unique position from which it can advocate strongly for market harmonisation and internationally-recognised standards where expected.

The inclusion framework formed to date is therefore the result of significant consultancy and support by HSBC to ensure the market model is fit for purpose.

HSBC’s broad-based, integrated ‘one bank’ franchise and client-driven strategy enables a rapid response to changing regional dynamics with agility, original thought and ability to deliver – this was well demonstrated through the Bank’s COVID response.

### HSBC — our market advocacy journey in Kuwait

- **Kuwait panel discussion with Head of Securities Services, HSBC Kuwait, as Moderator and CMA Deputy Chairman, Boursa Kuwait (SZX) and Head of a Regional Brokerage firm as panelists — MENAT Securities Forum held in Dubai**
- **Permanent extension of deadline for Custodian Rejection facility — HSBC drove this requirement in the market**
- **Introduction of Late Confirmation Process, which enables Custodians to accept previously rejected trades — HSBC’s recommendation**
- **MSCI announced that Kuwait Indexes will be added to the MSCI Emerging Market index and cited the recent market changes as factors in their decision — HSBC played an important role in these market developments**
- **Unification of settlement cycle to T+3 for all investors, introduction of international standard Corporate Action dates, and Custodian Rejection facility — All HSBC’s recommendations**
- **Introduction of Late Confirmation Process, a mechanism to enable settlement of previously rejected BUY trades — Also an HSBC recommendation**
- **Unification of settlement cycle to T+3 for all investors, introduction of international standard Corporate Action dates, and Custodian Rejection facility — All HSBC’s recommendations**
- **FTSE Russell classified Kuwait as Secondary Emerging and cited the market changes as factors leading to their decision to classify the market — HSBC played an important role in these market developments**
- **Temporary E-voting solution approved by CMA and made available by KCC — Another key HSBC recommendation**
- **Simplified account opening process rolled out — HSBC advocated for this change and was the first custodian to agree the process with the KCC**
- **Further exceptional process agreed due to COVID to enable electronic submission of requests**
- **A new market feature, being an Allocation model, was introduced in November ahead of the MSCI upgrade — HSBC participated in all market wide tests**
- **Netting (an HSBC recommendation) will be introduced after the MSCI upgrade**

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**May/June 2017**
- Kuwait panel discussion with Head of Securities Services, HSBC Kuwait, as Moderator and CMA Deputy Chairman, Boursa Kuwait (SZX) and Head of a Regional Brokerage firm as panelists — MENAT Securities Forum held in Dubai

**February/March 2017**
- Unification of settlement cycle to T+3 for all investors, introduction of international standard Corporate Action dates, and Custodian Rejection facility — All HSBC’s recommendations

**March/April 2017**
- Introduction of Late Confirmation Process; a mechanism to enable settlement of previously rejected BUY trades — Also an HSBC recommendation

**May 2017**
- Unification of settlement cycle to T+3 for all investors, introduction of international standard Corporate Action dates, and Custodian Rejection facility — All HSBC’s recommendations

**July/August 2017**
- Introduction of Late Confirmation Process, which enables Custodians to accept previously rejected trades — HSBC’s recommendation

**September 2017**
- MSCI announced that Kuwait Indexes will be added to the MSCI Emerging Market index and cited the recent market changes as factors in their decision — HSBC played an important role in these market developments

**August 2017**
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**September 2017**
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**September/October 2017**
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**November 2017**
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**December 2017**
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**October/November 2019**
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6 The journey to MSCI inclusion — A case study

While COVID-19 has affected timings in the lead-up to the MSCI upgrade, HSBC’s team has been able to effectively continue its work remotely. Among the key measures recommended (see timeline above), all have been adopted by stakeholder bodies. Meanwhile, the Bank’s own preparations for clients is ongoing:

Account opening
The finalisation of an agreement with the KCC in April this year has led to a simplification of the account opening process, and has significantly reduced the level of documentation and legalisation required from investors. The standard turnaround time to open a market account is now between 2-3 days compared to the previous timeframe of 10-15 days. When considering the restrictions at Country level due to COVID-19, HSBC reached a further agreement with the KCC to submit account opening requests electronically with physical documents to be submitted at a later date. This has enabled account opening activities to continue.

Scalability measures
HSBC has increased resources across its operations, as well as other Custody teams, in the run-up to inclusion.

Deadline extensions
HSBC had been in discussions with the KCC and made a number of recommendations on extended market deadlines in the lead up to and during the MSCI upgrade period which have been agreed by KCC. The Bank deadlines for rejection have been aligned to the new extended market deadlines.

Trade reporting
Increased frequency email reporting – a value-added service in addition to SWIFT reporting – from HSBC to clients and local brokers.

MSCI Guide
The Bank is producing a publication to explain to clients the details of the new market processes, including the measures taken by the market and the extended deadlines – both at market and HSBC level.

Client preparation
We also scheduled an interactive question and answer session for clients with particular focus on operations teams, to prepare them for the inclusion event and ensure a strong understanding of the market processes and applicable deadlines.
Looking forward with confidence

For a small Gulf nation, Kuwait has always been able to punch above its weight. Now, while facing a future that has to embrace sustainability, diverse revenue streams and long-term prosperity for its citizens, the country’s attractiveness to foreign investors is more important than ever.

As a large bank that is based on nurturing relationships, HSBC is committed to supporting our clients through their growth and development. We aim to help them transition seamlessly through market changes, and empower them to thrive.

“HSBC has been in Kuwait since 2005. Since then, we’ve been privileged to participate in the market development journey. We have established strong, collaborative relationships with the CMA and other market entities and have been at the forefront of ensuring successful implementation of the market changes. Leveraging our global network, we have become a trusted partner in market consultation processes to provide guidance and recommendations based on best international practice. We are committed to supporting the market in their drive for ongoing improvement.”

Emma Almerzah,
Head of Securities Services Kuwait