# Assessing the Environment, Regulation, and Selected Problems of Securities Markets: A Comparison of the United Kingdom with the Kingdom of Saudi Arabia and the United Arab Emirates

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## Intellectual Property and Publication Statements

The candidate confirms that the work submitted is her own and that appropriate credit has been given where reference has been made to the work of others.

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## Abstract

The main objective of this thesis is to review, contrast and compare some of the key equity market regulations emanating from the United Kingdom, Kingdom of Saudi Arabia and the United Arab Emirates. The thesis has researched several key themes in each of these markets in an attempt to pinpoint the key regulatory frameworks that are either lacking or under-represented with specific relevance to KSA and the UAE. The thesis has studied disclosure & transparency issues in the three chosen jurisdictions as well as the role played by the capital market regulator in each of them. This study intends to provide a regulatory analysis to influence those regulations that should be implemented to adjust market practices as they affect the Saudi and the UAE capital markets. The capital market regulations and rules passed by the governments in these countries are instrumental in the overall direction that a market takes. The thesis examines the role of the United Kingdom's Financial Conduct Authority (FCA) compared to that of Saudi Arabia's Capital Market Authority (CMA) and the United Arab Emirates Securities and Commodities Authority (SCA).

The research has found that key financial regulations such as those relating to market abuse, market conduct, transparency and corporate governance must be cognizant of the norms of the nation in which they apply. Furthermore, Saudi Arabia and to a larger extent, the UAE, have successfully emulated some of the key rules and regulations enacted in the UK to boost and build investor confidence. Having researched the rules and regulations in both Saudi and the UAE, the thesis finds that any perceived or actual lack of prevention of violations may be related to the financial authorities lack of intervention. Regulators in the GCC do not appear to move as swiftly nor take the necessary preventative measures as the UK's FCA does. With this in mind, the thesis concludes with recommendations including the reforms of capital market regulations in Kingdom of Saudi Arabia and the United Arab Emirates and with particular emphasis on transparency and disclosure, corporate governance and market abuse practices as well as the eventual adoption of the Twin Peaks model of regulatory reform which was recently championed by the Financial Conduct Authority in the UK.

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## Table of Abbreviations and Acronyms

| | |
|---|---|
| **ABS** | Asset Backed Securities |
| **ACRSC** | Appeal Committee for the Resolution of Securities Conflicts (KSA) |
| **ADX** | Abu Dhabi Securities Exchange |
| **AIM** | Alternative Investment Market |
| **AP/s** | Authorised Person/s (KSA) |
| **BOE** | Bank of England |
| **BSED** | The Banking Supervision and Examination Department |
| **CBUAE** | Central Bank of United Arab Emirates |
| **EDX** | International Equity Derivatives Business |
| **CDO** | Collaterised Debt Obligations |
| **CMA** | Capital Market Authority (KSA) |
| **CML** | Capital Market Law (KSA) |
| **CET** | Common External Tariff (GCC) |
| **CGRs** | Corporate Governance Regulations |
| **CJA** | Criminal Justice Act 1993 (UK) |
| **CRSD** | Committee for the Resolution of Securities Disputes (KSA) |
| **CREST** | Central securities depository (UK) |
| **DFM** | Dubai Financial Market |
| **DFSA** | Dubai Financial Services Authority |
| **DGCX** | Dubai Gold and Commodities Exchange |
| **DIB** | Dubai Islamic Bank |
| **DIFC** | Dubai International Financial Centre |
| **DTR** | Disclosure & Transparency Rules, FSA Handbook (UK) |
| **DMCC** | Dubai Multi Commodities Centre |
| **ECN's** | Electronic Communication Networks |
| **ESIS** | The Electronic Securities Information System (KSA) |
| **EU** | European Union |
| **EUA** | Economic Unity Agreement (GCC) |
| **FCA** | Financial Conduct Authority |
| **FINRA** | Financial Industry Regulatory Authority (US) |
| **FSA** | Financial Services Authority |
| **FSA 1986** | Financial Services Act of 1986 (UK) |
| **FSA 2000** | Financial Services Act of 2012 (UK) |
| **FSMA 2000** | Financial Services and Market Act of 2000 (UK) |
| **FSMT** | Financial Services and Markets Tribunal |

| | |
|---|---|
| **GATT** | General Agreement on Trade and Tariffs |
| **GCC** | Gulf Cooperation Council |
| **GDP** | Gross Domestic Product |
| **GDR** | Global Depository Receipts |
| **Hijri or sH** | The year used in the Islamic lunar calendar |
| **IOSCO** | International Organisation of Securities Commissions |
| **IPO** | Initial Public Offer |
| **KSA** | Kingdom of Saudi Arabia |
| **LSE** | London Stock Exchange |
| **MAR** | The Market Conduct Source book |
| **MAR 1** | Code of Market Conduct |
| **MAR 2** | Price Stabilising Rules |
| **MENA** | Middle East and North Africa (region) |
| **MiFID** | Markets in Financial Instruments Directive |
| **MOE** | Ministry of Economy (UAE) |
| **MOCI** | Ministry of Commerce and Industry (KSA) |
| **MSCI Index** | Morgan Stanley Capital International Index |
| **NASD** | National Association of Securities Dealers |
| **NASDAQ** | National Association of Securities Dealers Automated Quotations |
| **NYSE** | New York Stock Exchange |
| **OTC** | Over the Counter Market |
| **PRA** | Prudential Regulatory Authority (UK) |
| **PSM** | The London Stock Exchanges Professional Securities Market |
| **RAOs** | Regulated Activities Orders |
| **RNS** | Regulatory News Services (UK) |
| **SAMA** | Saudi Arabia Monetary Agency |
| **SCA** | Securities & Commodities Authority |
| **SEC** | Securities and Exchanges Commission (US) |
| **SETS** | Electronic Trading Service (UK) |
| **SROs** | Self-Regulatory Organisations |
| **SSRC** | Saudi Share Registration Company |
| **TADAWUL** | The Saudi Stock Exchange (trading in Arabic) |
| **TASI** | Tadawul All Share Index (KSA) |
| **TD** | The Treasury Department of the Central Bank of UAE |
| **TRACE** | The Trade Reporting and Compliance (UK) |
| **UAE** | United Arab Emirates |
| **UKLA** | United Kingdom Listing Authority |
| **US** | United States |
| **WTO** | World Trade Organisation |

## List of Cases

**The United Kingdom**

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3. The Companies Act of 1985
4. Financial Services Act, 1986
5. Public Offers of Securities Regulation, 1995
6. The Enterprise Act 2002
7. The Prospectus Regulations of 2005
8. The Companies Act of 2006
9. Financial Services and Markets Act, 2000
10. The Financial Services Act of 2012
11. FSA Code of Market Conduct
12. FSA Substantial Acquisition Rules
13. The Exchange Act Rule, 17 C.F.R. § 240.15c2-11 (2008).

**Kingdom of Saudi Arabia**

1. CMA Circular No. 2-28-2008 on 18 August 2008 (08/17/1429)
2. The Saudi Arabia Company Regulations Royal Decree No. M/6 of 1385 Hijri
3. The Capital Market Law of 2003
4. CMA Offers of Securities Regulation
5. CMA Listing Rules and Regulation
6. CMA Prudential Rules
7. CMA Authorised Persons Regulations
8. CMA Securities Business Regulations
9. CMA Market Conduct Regulations
10. CMA Corporate Governance Regulations
11. CMA Investment Fund Regulations
12. CMA Circular No. 2-28-2008 on 18 August 2008 (08/17/1429)
13. The Procedures of Resolution of Securities Disputes (PRSD) under resolution No (01-04-2011) dated 19/02/1432H corresponding 23/01/2011 to, pursuant to the Capital Market Law issued by the Royal Decree No (M/30) dated 02/06/1424H, corresponding to 31/ 07/ 2003G

**The United Arab Emirates**

1. Federal Law No. 10 of 1980 concerning the Central Bank, the Monetary System and organisation of Banking
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18. Local Decree No. 3/2000 on Abu Dhabi Securities Exchange
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# Introduction

## 1. Overview

The first and foremost function of financial regulation is to protect investors and ensure that markets operate smoothly and cohesively. The remit of regulation is responding to the need to ensure financial stability and adequate consumer protection, raising standards in transparency, systems and controls and conduct of business. Taken in isolation, none of these can cohesively glue together capital markets. However, taken in conjunction, they create a complex series of requirements that must be effectively balanced to ensure that financially regulated firms as well as licensed individuals operate within an optimal regime.

This thesis will capitalise on the experiences encountered by the researcher in many years of work in the securities regulatory environment. As any regulator the goal is to write and enforce regulations that would help construct a sound system that would provide the required level of protection for capital providers especially the retail and minority investors. Since both the KSA and the UAE are very young is the securities industry (10 to 15 years) they wanted to benefit from other regulators who had a long headway in this field, namely the UK.

The regulations use the civil law due to the construct of the regulatory systems and cultures of these countries. The legislators would approve high level principle-based provisions that would leave room for the implementing authorities to enact bylaws and executive rules for their personal to carry out these provisions in their day to day operations.

Although both the UAE and KSA are both Islamic countries and both do exert efforts in making Islamic products available to the traditional investors; they both to a large extent follow the free market economy paradigm. The reason for that is to assume an active role in the international financial system, to attract international capital along with the experience that come with it, and to offer the businesses a dual system to raise capital and to broaden the choice of investment venues to a wider spectrum of investors.

The thesis will focus on traditional finance vis-à-vis Islamic finance for the reasons mentioned above and due to the fact that Islamic products lacks the level of standardisation that is required by both local and international investors. It is well documented in literature[1] that there are numerous schools of thoughts within the Islamic system (*Shari'a*); what is found to be *Shari'a* compliant by some *Shari'a* scholars can be found prohibited by others. The approaches of the regulations discussed in this research have diverse approaches to regulating Islamic products. The KSA approach is to have the government enforce securities

[1] For example see Al-Zuhaili W. (1984) *Islamic Law and Its Evidence*. Syrian Arab Republic: Dar Al Fikr. [Arabic]. For a general overview about the principles of Islamic jurisprudence (*Uṣūl al-fiqh)* and school of thought see, Hallaq, W. B. (2005) *The Origins and Evolution of Islamic Law*. United Kingdom: Cambridge University Press; Hallaq, W. B. (2005) What is *Shari'a?.Yearbook of Islamic and Middle Eastern Law*. Volume 12. Issue 1. 151-180; and Hallaq, W. B.(1997) *A history of Islamic legal theories: an introduction to Sunnīuṣūl al-fiqh*. New York: Cambridge University Press.

regulations through entities other than the securities regulator including the issue of *Shari'a*.[2] While the UAE takes a completely different approach, the securities regulator commercialised some of the securities decisions and left them for the investing public like the case with the *Shari'a* decisions that are left to the industry to determine the school of thought they want to follow and the quality of the scholars and their fatwas.[3] The only requirement that the SCA requires is a statement by the issuer that it has a *Shari'a* board and it is that of *Shari'a* board's opinion that the product is *Shari'a* compliant.[4]

The investors will demand such product when they believe that the *Shari'a* board is credible and when the fatwa conforms to the beliefs of the majority of the investors. Hence, it is to the benefit of the issuer to choose a high quality and credible board with a fatwa that would make the financing costs low. The above mentioned reasons make the *Shari'a* issue outside the remit of this thesis and an issue in its own to be tackled in separate research.

This thesis will tackle issues of prominence in both academic and professional media. The added value in the academic literature would be to introduce an empirical dimension to comparative analysis of regulatory systems where researchers will get detailed exposure to newly formed as well as well-established jurisdictions like the UK. As a rule setting exercise this thesis will take into consideration six topics: Disclosure and Transparency Issues, Systemic Risk Management Issues, Shortage of the Investors Confidence, Insider dealing, False Accounting, and shortage of Corporate Governance.

In the professional dimension the findings of this research will be shared with professionals from the industry and the regulators to draw benefits by reforming existing regulations and introducing new ones. The analysis will look into account the different challenges in the main themes of the regulatory issues mentioned earlier, for example, cultural features will be stressed upon in some of the issues while regulatory differences will

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[2] In Saudi Arabia, a special judiciary has jurisdiction over all securities disputes. The Committee for the Resolution of Securities Disputes (CRSD) was established by Article 25 of the Saudi Arabia Capital Market Law No. (M/30) of 2003 to have exclusive jurisdiction over disputes and courses of action arising under this Law and its appurtenant rules and regulations. The law grants the CRSD a broad range of authorities and powers in order to effectively enforce the law and maintain fairness amongst securities market participants. See Cma.org.sa (2013) *Capital Market Law*. [Online] available from: http://www.cma.org.sa/En/AboutCMA/ CMALaw/Documents/CAPITAL%20MARKET%20LAW-26-8009.pdf. [Accessed: 13 June 2013]. While the CRSD functions as the court of first instance (or first degree court), the Appeal Committee for the Resolution of Securities Conflicts (ACRSC) functions as the appellate (or second degree) court. More information about the two committees are available in Chapters Four and Six, *infra*.

[3] Examples can be found in the Authority Board of Directors Decision No. (48) of 2012 Concerning the Regulation for Short Selling of Securities where Article 11 of the Regulation states that it shall apply to any agreement or arrangement that is consistent with the principles of Islamic *Shari'a* and permits a person to sell Securities that he does not own at the date of sale. In addition, Article 15 of the Authority Board Decision No. (47) of 2012 concerning the Regulations as to Lending and Borrowing Securities indicates that these Regulations shall apply to any agreement or arrangement that is consistent with the principles of Islamic *Shari'a* and permits the temporary transfer of ownership of Securities from one person to another. For full versions of these Decisions see, Sca.gov.ae (2012) *Rules and Regulation*s. [Online] available from: http://www.sca.gov.ae/ english/legalaffairs/pages/scaregulations.aspx. [Accessed 28 December 2012].

[4] Article 5 of the Authority Board of Directors Decision No. (16) of 2014 Concerning the Regulation of Sukuk (tradable financial instruments which represent a share of ownership of an asset or a group of assets and are issued in accordance with *Shari'a*) indicates that applications for the issuance and primary listing of sukuk states that such Sukuk must be approved by the *Shari'a* committee at the obligor or by the arranger. *Ibid*.

be more emphasised in others to give the readers the most benefit of this effort. In some instances the different natures of the systems being researched and the extent of the availability of information mandates examining issues by using different but similar variables that would serve the intended purpose.

This thesis is unique in that it is one of the few to research such a wide spectrum of topics (mentioned earlier) in such a great details to add to the limited existing literature and to enrich the regulatory experience in actual practice. It also attempts to find well thought and scientifically researched solutions to exiting inherent problems in the securities industry in both the KSA and the UAE, in particular the areas of enforcement and disclosure which constitute a good part of this work.

Furthermore, it taps on the long experience of a well-established jurisdiction that contributed greatly to setting the standards of the industry practice. One of the limitations that needed to be overcome though out the write up of this thesis was the shortage of resources that would serve in producing a comprehensive level of discussion and findings. This was remedied by delving into secondary and tertiary resources to verify the findings and conclusions and produce more credible outcomes.

This thesis has, in detail, reviewed the capital market regulations of both Kingdom of Saudi Arabia (KSA) and the United Arab Emirates (UAE) vis-à-vis those in the United Kingdom (UK). This is one of few works of its kind that provides extensive regulatory and legal evidence regarding the effectiveness of certain key financial reforms in the laws and institutions of the equity capital markets of KSA and the UAE.

This thesis acknowledges that promoting an adequate regulatory platform is necessary for the development of a broader and deeper equity capital market but accepts as inevitable that some of these reforms, particularly in KSA, will proceed at a less than satisfactory rate due, in part, to lack of up to date data coupled with a lack of clarity as to the mechanics of an efficient capital market. Creating new financial legislation is, after all, difficult in developing nations whose legal and societal traditions are at best weak in enforcement and financial regulatory development.

Furthermore, the evolution of KSA's and the UAE's financial systems cannot be correctly analysed nor understood in isolation from the state of their general economy. The UAE has experienced significant booms over the last decade or so and has a very forward and progressive government leadership in place. This open mindedness and willingness to change and adapt has served the UAE well, its economy is booming and the nation has become a magnet for international investors.

On the other hand, although KSA has the deepest market in the Middle East, it is, primarily, wholly dependent upon local investors. This insularity has not benefited KSA nor has it added to the development of the regulatory system. In the context of KSA, it was the collapse of KSA exchange at the beginning of 2006 which prompted KSA regulator to take steps to protect the securities market and investors as a precautionary measure, in case of further unpredicted future collapse.[5]

This thesis recognises these efforts as well as pointes out the less admirable changes or lack thereof in the financial and regulatory structure of the regime. Certainly, comparing the UAE's and KSA's financial regime to that of the UK may be construed as somewhat unfair. However, the benchmarks that most nations attempt to attain are those that are considered to be the best.

The UK regulatory regime is one of the most advanced and sophisticated on the globe and many developing nations have based their developmental policies on the UK model as a result of this supremacy. The UK regulatory system has had a long and distinguished history and has had the added advantage of developing and changing through trial and error over the last two hundred years. The scope and breadth of the UK markets is vast but it only fully developed into a cohesive regulatory platform via the 1986 Financial Services Act and the establishment of the Financial Services Authority (FSA). London is recognised globally as a leading financial centre with world-renowned capital markets primarily revolving around the London Stock Exchange (LSE).[6] All major financial institutions, hedge funds, private equity firms and investment banks are present in London. It is for this very reason that the regulatory platform in the UK has had to advance and constantly change to take account for the large presence of both local and international investors.[7]

The UAE government has been most pro-active in emulating the UK structure. Over the last few years alone the Emirates Securities and Commodities Authority (SCA) has passed several key regulations that, it is hoped, will serve to attract a greater number of foreign international investors to the market. This thesis recognises that such efforts by the financial regulators in the UAE have certainly contributed to the Morgan Stanley Capital International Index (MSCI)[8] ranking being upgraded from a 'frontier' to an 'emerging' market. A tremendous effort no doubt and one which shall bring further funds, investors and kudos to the nation.

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[5] The Saudi stock market suffered from six major collapses that resulted in significant depreciation of the general price index during the years of 1986, 1990, 1993, 1994, 1998, 2006, and 2008, but the worst was in 2006. For chronicle details on these crises, see Alanazi, B. M. A. (2012) Investor Protection and the Civil Liability for Defective Disclosures in the Saudi Securities Market: A Legal Analysis. *PhD Thesis*. Commonwealth of Australia: University of Wollongong, 'Introductory Chapter'.

[6] Londonstockexchange.com (2013) *Homepage*. [Online] available from: http://www.londonstockexchange.com/home/homepage.htm. [Accessed: 27 April 2013].

[7] Notably, in 2006, a total of £52 billion was raised from the London Stock Exchanges primary markets, with £29.4 billion of that raised by the 367 companies who chose to list on the Exchange. This is more than any other equity exchange in the world, and more than NYSE and NASDAQ combined. See Londonstockexchange.com (2007) *A Guide to Capital Markets.* [Online] available from: http://www.londonstockexchange.com/companies-and-advisors/listing/markets/guide-to-capital-markets.pdf. [Accessed: 27 April 2013]; and Londonstock exchange.com (2013) *Our History.* [Online] available from: http://www.londonstockexchange.com/about-the-exchange/companyoverview/our-history/our-history.htm. [Accessed: 22 June 2013]. For an updated figures, see Londonstockexchange.com (2014) *Main Market factsheets.* [Online] available from: http://www.londonstock exchange.com/statistics/ historic/main-market/main-market-factsheet-archive-2014/dec-14.pdf. [Accessed: 27 April 2015].

[8] Msci.com (2014) *Morgan Stanley Capital International*. [Online] available from: https://www.msci.com. [Accessed: 21 August 2014].

The financial crisis of 2008 and 2009 demonstrated that when things go wrong in the financial sector, the impact on the economy can be severe. The financial crisis exposed the inherent weaknesses in the 'tripartite' system of regulation in the UK. Perhaps the most significant failing is that no single institution had responsibility, authority or powers to oversee the financial system as a whole. Before the crisis, the Bank of England (BOE) had nominal responsibility for financial stability but lacked the tools to put this into effect; the HM Treasury, meanwhile, had no clear responsibility for dealing with a crisis which put billions of pounds of public funds at risk. All responsibility for financial regulation was in the hands of a single, monolithic regulator, the Financial Services Authority (FSA), and there was clearly, in the run-up to the financial crisis, too much reliance on 'tick-box' compliance, or as called "window-dressing" regulation.[9]

That is why the Government pushed ahead at the time with its plans to reform the UK system by following the Twin Peaks model, hence, establishing a macro-prudential regulator, the Financial Policy Committee (FPC) within the Bank of England to monitor and respond to systemic risks; transferring responsibility for prudential regulation to a focused new regulator, the Prudential Regulation Authority (PRA), established as a subsidiary of the Bank of England; and creating a focused new conduct of business regulator, the Financial Conduct Authority (FCA), to ensure that business across financial services and markets was conducted in a way that advances the interests of all users and participants. It is clear that the FCA as the financial market conduct regulator has broad ranging responsibility in both retail and wholesale markets. It will continue to have responsibility for areas previously held by the FSA and will potentially take on responsibilities in new areas such as consumer credit. The FCA's responsibility as market conduct regulator can be split into three areas:

i. supervising trading of financial instruments infrastructure (other than systemically important infrastructure – central counterparty settlement systems and clearing houses – for which the Bank of England will be responsible).
ii. supervising markets for issuing of securities, including the UK Listing Authority. The FCA will perform the functions that the FSA previously performed and will therefore be responsible for reviewing and approving prospectuses and circulars, determining eligibility for listing and maintaining the Official List.
ii. oversight of on-exchange and over-the-counter markets and monitoring to prevent market abuse. The FCA will also police the ongoing compliance of issuers and major shareholders with the ad hoc and periodic disclosures required under the Disclosure and Transparency and Listing Rules.

Financial regulators, in particular, the PRA and the FCA are committed to a fundamental overhaul of regulation to make sure that the financial system stays abreast of

[9] HM Treasury (2010) *A new approach to financial regulation: judgment, focus and stability, Presentation to Parliament*. [Online] available from: https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/81389/consult_financial_regulation_condoc.pdf. [Accessed: 15 March 2012].See also, Miller, M. et al. (2010) *Restoring prudent banking in Britain: evidence and policy*. University of Warwick. [Online] available from: http://www.ashmus.ox.ac.uk/winton/PastSeminars/Michaelmas2010/FinancialCrisesSeminars/Miller29Nov _paper.pdf. [Accessed: 15 March 2012]; and Black, J. (2012) Paradoxes and Failures: 'New Governance' Techniques and the Financial Crisis'. *The Modern Law Review*. Volume 75. Issue 6. 1042.

global trends. The developments after the financial crisis in such a developed market like the UK was followed with keen interest globally and especially in the Arab world. The impact of these developments can be seen in both the jurisdictions under study in this thesis, the specifics of which will be examined in detail in the subsequent chapters.

**2. Aims and Objectives of the Thesis.**

The scope of the thesis is as follows:

a. It will examine the current business and regulatory environments of the public securities markets; securities regulatory systems, processes, and objectives; and the degrees to which these systems actually achieve their intended goals within each of the three jurisdictions to be examined in Chapter One. The well-developed and historically old, westernised jurisdiction of the UK will be compared and contrasted with two relatively younger, emerging Arabian jurisdictions, the KSA and the UAE.

b. The thesis will commence with an examination of the historic foundations upon which the securities regulatory mechanisms of each of the three separate jurisdictions being compared and contrasted currently rest. From these historic fundamentals, the goals and policy objectives which underlie attempts to regulate securities and the markets within which they are traded will be discerned, identified, and explained in Chapter Two. To the extent that policy objectives may differ as within the three separate jurisdictions that are the subject of this inquiry, the nature of the differences and the underlying reasons therefore, will be examined and explained in subsequent Chapters of the thesis

c. In the next three Chapters, both the fundamental as well as the legal and technical underpinnings for the securities regulatory laws, regulations, and rules of each of the three subject jurisdictions will be examined and explained, as well as compared and contrasted with one another. The nature and respective roles of the actual principal regulatory authorities themselves – the former Financial Services Authority in the UK and the subsequent Twin Peaks system; the Capital Market Authority in KSA; and the Securities and Commodities Authority in the UAE – will also be examined and illuminated.

d. Fundamentally, the thesis will take advantage of, and endeavor to explain, the lessons that have been learned over the many years that securities and their trading markets have been regulated within the jurisdiction of the UK. The essential objective of the thesis will be to apply these lessons to the less-developed regulatory environments and structures that now exist within KSA and the UAE, by first identifying, and then arguing in favor of, the adoption of regulatory mechanisms that have been applied within the older UK jurisdiction and found to have led ultimately to solutions to many of the same problems, difficulties, and abuses that the two younger jurisdictions, and the markets that operate within them, have experienced, and continue to experience, during what are still those latter markets' relatively formative years.

e. As with the case of all-things-new, the evolving markets of KSA and the UAE have also experienced various issues and problems that are either unique to both of these markets vis-a-vis the other, more mature markets of the UK and other Western jurisdictions, or in some cases strictly unique to one or the other of these two particular countries.

f. Overall, it may be said of this thesis that its principal objectives are those of first setting a historical background to use as a backdrop for what will later be the identification and dissection of the assortment of endemic problems that have characterised, and continue to characterise, each of the subject securities markets. The problems have been identified and thoroughly analysed in Chapter Six and suggested approaches will be formulated that could be utilised for the purpose of either resolving, or to the fullest extent possible, minimising, these problems, with a view toward ultimately leading to reforms in the way securities are traded within each of the three subject jurisdictions in Chapter Seven.

## 3. Thesis Methodology.

In terms of documentary research, papers, statistics, data, documents of institutions and associations, newspapers, magazines, websites as well as scholarly journals and secondary news sources were the main sources for this thesis. All research was conducted via computer and all primary data, such as legislation and laws, was sourced from respective internet websites.The following institution's research and regulatory data bases were accessed, amongst others, for primary research: The Financial Conduct Authority in London as well as the Bank of England, the Treasury and Parliament in the UK, the Capital Market Authority of KSA, Saudi Arabian Monetary Authority, the Securities & Commodities Authority UAE, and the UAE Ministry of Economy.

The research itself required substantial preparation and selection. Not all relevant laws could be defined and contrasted since clearly, that task would be beyond the remit of this thesis. The relevant associations and institutions had to be identified and assessed as to suitability. For example, data accumulation in the Middle East as well as good quality research is hard to come by whereas data and research available on the UK regulatory environment is significant and abundant. Clarifying and selecting the most pertinent information therefore was one of the key challenges of this thesis.

## 4. Outline of the Thesis.

This thesis is laid out in eight Chapters beginning with this introduction that presented the aims and objectives of the thesis, the questions, methodology, and the outline. The first Chapter indicates in brief a historical background on the origin and development of securities markets with special focus on globalisation. The legal frameworks and markets in the UK, KSA, and the UAE were generally described.

The second Chapter provides a detailed description and a historical perspective on the goals, policy and objectives of securities regulations. It further explains the natural progression of inherent risks in financial markets and the persisting need for regulators and regulations to manage these risks. A brief on the historical outline of this process was described in some of the pioneering countries, especially the UK.

The third Chapter discusses, in detail, the regulatory environment within the United Kingdom with a strong emphasis on the role of the Financial Conduct Authority (FCA). The with particular reference to the Financial Services Act of 1986, the Financial Services & Markets Act of 2000 as well as the newly adopted Financial Services Act of 2012. The key reasons for the adoption of the newly passed act are highlighted and discussed as well as the UK Shift from "Integrated" to "Twin Peaks" system.

The UK's shift from an integrated financial regulatory system to the twin peaks model carefully contrasted and the benefits and advantages highlighted as well. It is clear that the goals and objectives of the incumbent regulator, namely the FCA in this case, must be in alignment with the overall vision and aims of the regulatory act supporting it to avoid any regulatory misinterpretations. The effect of the Financial Services Act passed in 2012 has yet to be discerned but it is hoped that the results of the meltdown experienced in the last financial crisis can be avoided or mitigated by the adoption of the twin peaks model as envisaged by the new financial act.

The fourth Chapter will examine the regulatory environment within the Kingdom of Saudi Arabia. A historical background reveals that the regulatory environment in KSA has traditionally been quite archaic and insipid as a result of the inward looking approach adopted by authorities. Before the establishment of the Saudi Arabian Monetary Authority (SAMA), which is the current regulator of the banking industry, KSA market operated in an informal manner with no strict rules and regulations binding parties together. However, with the adoption of the Capital Market Law (CML) and the establishment of the Capital Market Authority (CMA) in 2004, KSA equity market has grown from strength to strength.

The role of the Arab world's largest stock market, namely Tadawul, has been globally emphasised and this role has persuaded KSA authorities to address some of the key issues that must be changed in order for KSA to emerge as a key destination for international investors. Some of the key regulations passed by the CMA including Tadawul's listing rules, securities business regulations, and corporate governance are also examined and addressed as to their suitability.

The fifth Chapter analyses the United Arab Emirates (UAE's) financial and regulatory environment with an introduction to the historical background and development of the equity capital market over the last few decades. The UAE's equity market is a lot more varied and diverse than that of KSA and examination of the primary securities regulators and stock exchanges in Dubai and Abu Dhabi clearly highlights this variation. The UAE's SCA is the primary equity market regulator in the UAE and has been responsible since inception in 2000 for the issuance of several key legislative rules including the regulation of brokers and financial advisors as well as the recent approval for the introduction of liquidity providers and market makers into the equation. The SCA's role has been pivotal as a bridge between gauging investors' needs and the balancing government and federal financial policy in meeting those needs.

The SCA closely benchmarks international best practices including those of the UK and the US in particular in the hopes of attracting continued foreign investment, and the lifeblood of the nation. Laws and regulations passed by regulators are examined in light of the government's strong desire to re-structure the financial regulatory environment alongside the twin peaks model adopted by the British via the creation of the FCA. Under this new Twin Peaks structure, the UAE Central Bank shall be required to exercise the prudential supervision of financial enterprises and the SCA will be required to exercise the supervision of conduct of the financial markets and to decide on the admission of financial enterprises to those markets.

The sixth Chapter is a comparison between key regulatory problems in the UK, KSA and the UAE. Some of the key issues examined include disclosure and transparency related to the secondary markets. The transparency of a market plays a direct role in investor confidence and as the thesis demonstrates, transparent markets attract deeper pools of capital. The chapter also compares and contrasts corporate governance issues, false accounting, systemic risk and insider dealing[10] in the three jurisdictions.

The seventh Chapter discusses the historical regulatory solutions presented by the three jurisdictions. The important role of the financial regulators such as the newly minted FCA, KSA's CMA and the UAE's the SCA are examined in light of the solutions advanced to solve and alleviate transparency, disclosure and corporate governance issues. Suggestions to ameliorate problems in regimes are emphasised as well as legislative tools used for making changes to the system with corresponding examples are illustrated. Among the key issues discussed are the restrictions placed on foreign ownership in KSA and the UAE markets.

Chapter eight concludes the thesis by offering the researcher's recommendations and suggestions with regard to the regulatory framework discussed in this thesis. The thesis has researched several key themes in each of these markets in an attempt to pinpoint the key regulatory frameworks that are either lacking or under-represented with specific relevance to the UAE and KSA vis-à-vis the UK.

Finally, a brief write-up is presented at the beginning of each Chapter which presents the part of the thesis objectives which are covered in that Chapter by highlighting the main topics presented as well as outlining the flow of the contents in those topics.

[10] Notably, the term 'insider dealing' will be used as synonymous with the term 'insider trading'. In KSA as in the US, it is known as insider trading, while in the EU countries and UK the term insider dealing is used. Also the term 'inside information' will be used interchangeably with the terms 'sensitive non-public information' and 'material, nonpublic information.'

## Chapter one

## The History of the Public Securities Markets

This Chapter traces the beginning and evolution of trading in securities, first for the pioneering western markets, especially the UK; then proceeds to identify similar pattern of evolution of the markets in the history of KSA and the UAE financial markets.

### 1.1 The Origin and Source of Securities Markets

#### 1.1.1 Increasing Globalisation.

The first known stock exchange (secondary market) dates back to 12th century, when the first brokers are believed to have commenced trading in debt and government securities. Unofficial secondary share markets existed throughout Western Europe through the 1600s, where brokers would meet outside or in coffee houses to make trades. When it began trading shares of the Dutch East India Company the Amsterdam Stock Exchange became the first "official" securities exchange in 1611.[11] By the early 1700s there were fully operational stock exchanges in France, England, and America followed in the later part of the century.

The phenomenon of "increasing globalisation" is not something that is a mere creature of the world's securities markets. In order to be properly viewed within context, globalisation must be thought of in terms of something that first began happening around the early 1990's, and happening not just in stock markets. It is a landmark, watershed event that encompasses nearly every sector of civilised society, from the very manner in which people interact socially (e.g., Facebook, MySpace, Twitter, and numerous other social media Internet sites), to the way that transnational economies function. Most of what qualifies under the all-encompassing label of "globalisation" consists of developments that were first fostered by enhanced electronic technology that had not, up until the early 1990's, been previously available, principal among them being the ability to communicate on a world-wide basis virtually instantaneously, through such comparatively new developments as telefax machines and, later, electronic mail ("e-mail").

As a result of the sweeping and constantly changing effects of technology, an explosion of internet and computer based trading systems has changed our perception of stock markets. Anyone, anywhere can trade from home today. Stock exchanges are completely accessible from anywhere in the world. Twenty years ago this would have been unheard of and investors would have been forced to go through a long and lengthy process in order to register, open an account, transfer funds and make phone calls to their brokers. This is no longer the case today. Contemporary investors, from the smallest individual shareholder

[11] The Dutch East India Company, (Vereinigte Oostindische Compaignie), was formed in 1600 and was engaged in the spice trade to India and Far East. The very first stock certificate that history records was issued by this company in 1606. See Valdez, S. & Molyneux, P. (2013) *An Introduction to Global Financial Markets*. 7th Ed. United States: Palgrave Macmillan.155-56.

to the largest institutions, are demanding and increasingly getting instant access to information and immediate execution of trades. Accordingly, stock markets have to change to meet these needs. Today's generation of stock markets must provide worldwide and instantaneous price discovery via sophisticated electronic communication networks (ECN's), allow for trade executions in a fair, orderly and low-cost environment without time zone limitations and thus must provide regulations that facilitate this phenomenon.

The proliferation of ECN's has forced stock markets over the world to review their survival strategies. Mergers and buy-outs have become customary between exchanges in the last decade. During the last decade the market structure for stock trading in Europe has experienced some major changes. A number of mergers and acquisitions have been made, for example, the Euronext merger (2005), the NYSE acquisition of Euronext (2006), the OMX merger (2003-2006), the NASDAQ acquisition of the OMX Nordic stock exchange (2007), and the merger between the LSE and Borsa Italian (2007) have all been directly impacted in some form or other by the advent of globalisation and technological advances.[12]

With globalisation of the markets, there are a number of new factors that continue to affect the operation of the stock exchanges. Listing rules have been harmonised on major global exchanges and information disclosure requirements are generally similar on the major stock markets. The way companies present their annual and quarterly statements is moving towards a set of harmonised international standards. Some multinational enterprises are raising new capital on several stock markets simultaneously. This requires coordination between exchanges. It is increasingly being realised that the home country of a company which has shareholders around the world has a responsibility for ensuring that price-sensitive and material information is available to all shareholders and not just to those in the home country.

Thus international regulatory initiatives, particularly those aimed at standardising accounting and other disclosure requirements need to be enforced vigorously. These changes will further empower investors, giving them more control over trading in these global markets and access to company information that is formatted to a global standard. The combination of institutionalisation, automation and globalisation will lead to more market liquidity, greater volatility and lower trading costs. It would therefore appear that the world's stock markets are heading rapidly toward globalisation through two major changes namely, the liberalisation of international stock trading rules, and the globalisation of stock trading practices.

Therefore, globalisation of securities markets generally refers to two key aspects. The first is the global phenomenon of being able to trade during 24 hours, where access to capital markets is increasingly being open cross-jurisdictionally. The second is the phenomenon of multiple listing and the adoption of many standardised international regulatory rules vis-à-vis many aspects of capital market trading and settlements (i.e.: through the adoption of regulatory "harmonisation", cross-jurisdictional "minimum" standards or "equivalence" in

[12] World-Exchanges.com (2014) *FOCUS*. February 2012. [Online] available from: http://www.world-exchanges.org/files/focus/pdf/focus_february.pdf [Accessed: 30 November 2014].

regulation). In this respect, one can easily, for example, discern the regulatory impact of the EU on the internationalisation of securities markets in the latter sense.[13]

Up until fairly recently, the majority view among economists on the question of whether the international integration of financial markets that has been the inevitable result of increasing globalisation was quite positive. Many qualified writers on the subject have viewed the benefits of wide, deep, and most importantly, open capital markets as including features such as international portfolio diversification, optimal resource allocation on a transnational basis, and the discipline on policy makers that transnationalisation necessarily imposes. This optimism has proven to be somewhat short-lived, however, given the series of monetary and debt crises that first afflicted Latin America and nations in the Asian region – crises which, while thought to be quite serious at the time they arrived, turned out to be the harbinger of the even worse calamities which for the past two-to-three years have infected the member nations of the European Union.[14] These events have led some economists and policymakers to assert that the costs of complete liberalisation of financial markets for emerging countries may far outweigh the benefits.[15]

The primary role of financial globalisation in the development of financial markets can be summed up in a single word: GROWTH.[16] Despite some regional crises and the failure of up to half of the world to participate, until very recently (namely, the years in the aftermath of the worldwide 2008 financial meltdown that commenced with the collapse of the American housing market, which was immediately followed by the collapse of

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[13] Al-Rimawi, L. (2001) Securities markets: Instruments, globalisation and benefits for emerging economies. *Arab Bank Review*. Volume 3 (2), 33-44.

[14] Ross, J. M. (1995) The globalisation of financial markets and its impact on the financial services industry. *MSc Thesis*. United Kingdom: Heriot Watt University.

[15] *Ibid*, 73-83. See also Kose, M. A., Prasad E. S. & Terrones M. E. (2009) Does financial globalization promote risk sharing?. *Journal of Development Economics*. Volume 89. Issue (2), 258-270; Berg, A., Borensztein, E. & Pattillo, C. (2004) Assessing Early Warning Systems: How Have They Worked in Practice?. *IMF*. Working Paper 04/52; Rodrik, D. & Velasco, A. (1999) Short-term capital flows. *The National Bureau of Economic Research*. Working Paper No. w7364. September 1999. [Online] available from: http://papers.ssrn.com/sol3/papers.cfm?abstract_id=194648. [Accessed: 28 August 2014]; Clausen, N. J. (2000) Securities market co-operation: A new regulatory standard in the next millennium. *The Company Lawyer*. Volume 21. Issue (2).; Furman, J. & Stiglitz, J. E. (1999a) Economic crises: evidence and insights from East Asia. *Brookings Papers on Economic Activity*. Brookings Institution. Washington. No. 2. 1-64; and Knight, M. D. (1998) Developing Countries and the Globalization of Financial Markets. Monetary and Exchange Affairs Department. *World Development*. Volume 26. Issue (7). July 1998. [Online] available from: http://www.imf.org/ external/pubs/ ft/wp/wp98105.pdf. [Accessed: 23 March 2013]. For more information on the topic in relation to the GCC and Arab Countries, see Alonso-Gamo P. et al. (1997) Globalisation and Growth Prospects in Arab Countries. Middle Eastern Department. *International Monetary Fund*. WP/97/125; El Serafi, H. & Abdel Shahid, S. F. (2002) *World Stock Exchanges are integrating/consolidating/merging: what could be done by Arab Exchanges?*. Cairo & Alexandria Exchanges Working Paper Series. No. 2. [Online] available from: http://www.egx.com.eg/pdf/world_stock_exchanges.pdf. [Accessed: 15 March 2012]; Talet, N. A. (2004) The Establishment of WTO tailored according to the Growth of Information. In *Legal & Economic Aspects of the World Trade Organization Agreements Conference*. Dubai. 9th to 11th May 2004. UAE University & Dubai Chamber of Commerce Publication. Volume 6. 1-35; and Al-Yousif, K. Y. (2004) The GCC, the WTO, and Development. In *Legal & Economic Aspects of the World Trade Organization Agreements Conference*. Dubai, 9th to 11th May 2004. UAE University & Dubai Chamber of Commerce Publication. Volume 6. 105-133.

[16] Bekaert, G., Harvey, C. R. & Lundblad, C. (2005) Does financial liberalization spur growth?. *Journal of Financial Economics*. Volume 77. Issue (1). 3–55.

securitised mortgage obligations that had been underwritten by, among other famous names, the now-failed Wall Street financial firm of Lehman Brothers) the years of globalisation were also years of sustained economic growth in all types of countries.[17] Conventional macroeconomic theory provides ample support for the theory that trade, in almost every situation, brings consumption benefits to both sides of each individual transaction, this is in turn is communicated to financial markets and hence their growth and development.

The milestones of the new wave of globalisation seem to have been the stock market deregulation in the USA in 1975, the removal of capital movement controls in various countries, and the new generation of regional trade agreements such as the Maastricht Treaty (deepening the European Union) in 1991, the MERCOSUR Treaty of 1991, the Association of Southeast Asian Nations (ASEAN) Free Trade Area of 1992, and the North America Free Trade Agreement (NAFTA) of 1994. Together with innovations and competition which reduced the costs of transportation and communications, these government regulatory decisions helped stimulate the decisions of firms to invest in new areas and new technologies and eventually creating new wealth as successful entrepreneurs invested and consumed in the virtuous circle of economic growth. While the growth to today's hyperactive financial markets following each other through the day from Asia to Europe to the Arabian Gulf to North America, and in which news of economic or market developments in a particular region or a particular industry is translated within hours to the financial market values of firms in that region or industry.[18]

It seems that a large part of the problems that do not help the development of financial markets, stem from the increased competitiveness and risk taking among the largest banks in the developing nations as these increasingly depend on profits from in-house trading operations, or in other words, speculation on all sorts of financial matters, while even the money-lending portion of the banking business has grown riskier as bankers seek new markets for loans among other financial institutions (which are engaged in speculation themselves) or low end retail consumers, presumably the first to be affected by any possible recession. These factors were all forerunners of the world financial crisis that first became manifest beginning in December, 2007; to a remarkable degree, they are still factors and behaviors that remain characteristic as the world slowly tries its best to recover from the numerous business debacles that were brought to light following the onset of that crisis.[19]

The optimistic answer in this situation would be that so far the financial crises in Mexico, East Asia, Russia, and the Eurozone have been contained by national and international action, and that after relatively brief periods of correction, financial markets have generally resumed their upward course, at least in the developed nations. That was true up until December, 2007. As for the validity of the theory following the aftermath of that still-extant worldwide meltdown, the best that can really be said is that "much remains to be seen."

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[17] Das, D. K. (2004) *The Economic Dimensions of Globalization*. United States: Palgrave Macmillan.
[18] Dicken, P. (2015) *Global Shift: Mapping the Changing Contours of the World Economy*. 7th Ed. United States: SAGE Publications Ltd.
[19] *Ibid*.

One final disadvantage of financial globalisation that should be mentioned is the loss of control suffered, or perceived to be suffered, by governments, businesses, and individuals and hence financial markets. [20] Clearly, situations of over investment boom-and-bust, as in southeast Asia, Russia, and the Eurozone, represent businesses losing control over their own fate in the course of competition. Situations of government loss of control over the course of the economy and the relationship of national institutions might be illustrated by several examples, such as the political hesitations in both the developed United States and developing India towards placing their trade policy fully under the control of multinational institutions, or the story of how President Obama personally intervened, apparently in response to campaign contributions from American exporters, to greatly loosen rules governing high technology exports to China, and how this has become a political issue in America, as well as a potential threat to both American military security and America's high tech manufacturing leadership.[21]

Whether the wave of financial globalisation that has swept the world in the last three decades will be seen as primarily advantageous or primarily disadvantageous to financial markets will depend, of course, largely on how the story turns out – specifically, whether the warnings by many economists of yet another worldwide, deflationary recession come true, and whether the humiliations of this (possible) outcome outweigh the pleasure of the booming phase of the cycle (as seems to have happened with the 1930's versus the 1920's, and more recently with the post-2007 years versus the 1990's). It is inherently difficult to pass judgment on these predictions of economic depression; on one hand, thinking about such predictions is frightening (which clouds one's judgment), but on the other hand, many predictions never come true – though some do. The optimist would point out that markets always tend to rebound – *eventually*.[22]

## 1.2 The Markets of the United Kingdom.

The LSE is a stock exchange located in the City of London. The Exchange was founded in 1801 and is part of the London Stock Exchange Group.[23]As of December 2013, the Exchange had a market capitalisation of US$4.429trillion, making it the fourth-largest stock exchange in the world by this measurement (and the largest in Europe).[24]

The LSE was a booming market, for the most part, in the years following World War II. Like all other markets, it tended to be cyclical, and had its share of ups and downs, bear markets followed by bull markets followed, inevitably, by bear markets, in an endlessly-

[20] Cerny, P. G. (1994) The dynamics of financial globalization: Technology, market structure, and policy response. *Policy Sciences*. Volume 27. Issue 4. 319-342.
[21] Dicken P. (2015) *'Global Shift…'*, *supra* note 18.
[22] The famous economist John Maynard Keynes was once asked his opinion about where the stock markets might be headed "in the long term," to which he replied, "In the long term, we are all dead." See Keynes, J. M. (1923) *A Tract on Monetary Reform*. United States: Macmillan and co., limited Harcourt, Brace and Company.
[23] See London Stock Exchange, *supra* notes 6 & 7.
[24] *Ibid*. See also World-Exchanges.com (2014) *WFE 2013 Market Highlights*. No. 228. 28 January 2014. [Online] available from: http://www.world-exchanges.org/files/2013_WFE_Market_Highlights.pdf. [Accessed: 23 September 2014].

repeating cycle. But by far and away the most talked-about development in this Market in the post-World War II years was the time of the "Big Bang," brought about in 1986 by the sudden deregulation of the financial markets in the UK. The phrase "Big Bang" was coined to describe measures including abolition of fixed commission charges and of the distinction between stockjobbers and stockbrokers on the LSE, as well as change from an open-outcry to electronic, screen-based trading.[25]

In 1995, the Exchange launched the Alternative Investment Market "AIM," [26] to allow growing companies to expand to international markets. Two years later the Electronic Trading Service (SETS) was launched, bringing greater speed and efficiency to the market. Following this, the CREST settlement service was also launched. On the year of the new millennium, 2000, the Exchange's shareholders voted to become a public limited company: London Stock Exchange plc. The LSE also transferred its role as UK Listing Authority to the Financial Services Authority ("FSA-UKLA").[27]

EDX London, a new international equity derivatives business, was created in 2003 in partnership with OM Group. The Exchange also acquired Proquote Limited, a new generation supplier of real-time market data and trading systems. The old Stock Exchange Tower became largely redundant with the advent of the Big Bang, which deregulated many of the Stock Exchange's activities as it enabled an increased use of computerised systems that allowed dealing rooms to take precedence over face to face trading. In 2007 the LSE merged with BorsaItaliana, creating the London Stock Exchange Group ("LSEG").[28]

During the 1980s, the major British banks had secured an unrivalled position in that country's retail securities market by combining an extensive branch network with a broking and dealing facility. Only the development of online broking provided an opportunity for others to enter the retail side of the securities market, with the largest US firm, Charles Schwab, establishing a foothold in the late 1990s at the time of the dot.com boom.

In the wholesale market the position was different, with strong competition for the business of large institutional investors. Major banks and brokers, including many from abroad, were willing to buy and sell at very low rates of commission or for free, expecting to profit from the difference between the buying and selling price. Institutional business was concentrated in the hands of a small number of financial firms as only they had the extensive resources and connections necessary.Some of these were British but most were not. The largest London dealers, Smith New Court, became part of MerrillLynch, whilst the most prestigious broker, Casenoves, allied itself with J. P. Morgan Chase. By 1999, membership of the LSE was down to 298, with 80% of all trading being done by only sixty large banks and brokers. The level of concentration was even greater by 2005 when ten firms did 50% of

[25] For a further examination of the transformation of the 'big bang', see Gower, L. C. B. (1998) "Big Bang" and the City Regulation. *The Modern Law Review*. Volume 51. Issue (1).
[26] See Londonstockexchange.com (2013) *AIM Homepage*. [Online] available from: http://www.londonstock exchange.com/companies-and-advisors/aim/aim/aim.htm. [Accessed: 23 March 2013].
[27] Fsa.org.uk (2012) *Financial Services Authority*. [Online] available from: http://www.fsa.gov.uk. [Accessed: 25 December 2012].
[28] See London Stock Exchange, *supra* note 6.

the trading. By then the LSE had become a suite of markets catering for distinct groups of investors and served by banks and brokers from home and abroad.[29]

Due to Big Bang, the LSE had made the successful transition from a floor-based trading system to a screen/telephone-based one. However, many of the vestiges of the old restrictive practices remained and further progress was slow. Until 1995 there were attempts to monopolise trading by limiting access to the prices generated by market-makers. It was not until 1997 that a fully electronic market place was introduced where trading could take place on-screen and a central computer automatically match orders in terms of securities, amounts, and prices. Similarly, it was not until 2000 that the LSE was converted from a member-owned institution into a company, so giving it the flexibility to compete internationally. Accompanying this change in status was the final abandonment by the LSE of the wider regulatory powers it had acquired during and after the Second World War such as control over the dissemination of price sensitive information and policing broker–client relationships. Instead, the LSE became subject to the Financial Services Authority, which had been set up in 1997 to oversee the entire British financial system, including the international activities taking place in London.[30]

Thus, the LSE was no different from any of the other securities markets operating out of London, whether it was the Swiss Stock Exchange, Virt X, the government bond trading platform Euro MTS, or the international organisation supervising the Eurobond market. At one level was the AIM, which traded the issues of new and small companies. These were riskier investments involving fewer safeguards to protect investors, with many of the stocks traded being issued by companies operating in such fields as new technology, pharmaceuticals, mining, and oil exploration. By the early 2000s, AIM had established itself as one of the world's most successful junior markets, attracting listings from numerous companies from outside Britain.Finally, the LSE also provided a market for foreign companies that attracted the interest of the international investment community such as a succession of Russian enterprises operating in a variety of sectors. The LSE was no longer exclusively identified with British companies and British investors. Crucial to the success of the LSE a securities market were the facilities it provided through which securities could be easily and cheaply traded.[31]

## 1.3 The Markets of the Kingdom of Saudi Arabia and the United Arab Emirates.

### 1.3.1 Background Information on the Gulf Cooperation Council (GCC) and Markets in General.

The Gulf Cooperation Council (GCC) was formed in 1981, as a regional organisation comprising of six countries: Kingdom of Saudi Arabia, Kuwait, Bahrain, Oman, the United

[29] Michie, R. C. (2006) *The Global Securities Market: A History*. United States: Oxford University Press.
[30] *Ibid*.
[31] See Londonstockexchange.com (2013) *A Guide to AIM*. 2010. [Online] available from: http://www.londonstock exchange.com/companies-and-advisors/aim/publications/documents/a-guide-to-aim.pdf. [Accessed: 23 March 2013].

Arab Emirates and Qatar. Its aim was to achieve economic and political integration in the wake of the second oil-price shock and political change in the region. The most salient objective of the GCC programme is to achieve — eventually — a confederal framework in which the political, economic and social policies of the member states are gradually integrated.[32]

The GCC States enjoy close similarities; common language— Arabic, a common religion—Islam, closely comparable social structures, roughly the same economic developments, very similar systems of governments, a collective culture and shared geography characteristics.[33] Also, the GCC economies are broadly similar in characteristics. First, the main source of government income is derived from oil and gas exports. Second, the growth of the economy is largely affected by changes in primary energy prices and government expenditure.[34]

All these factors, enhanced by one geographical entity extending from sea to desert, have facilitated contacts and interaction among them, and created homogeneous values and characteristics. Therefore, while, on one hand, the GCC is a continuation, evolution and institutionalisation of old prevailing realities, it is, on the other hand, a practical answer to the challenges of security and economic development in the area. It is also a fulfillment of the aspirations of its citizens towards some sort of Arab regional unity.[35]

Free movement of capital, services and persons are the GCC Charter cornerstones on which the Council legislative competence in the economic field is based. Thus, the Council has adopted, or in the implementation process in some areas, several vital policies in the economic field which are aimed at accelerating joint economic action. The most important are those relating to the establishment of common market, customs, economic and monetary union. Moreover, the GCC Charter has also provided the basis for further conventions intended to ratify and develop specific areas of cooperation. In this regard, the most far-reaching of the subsidiary legal instruments to emerge from the Charter is the Economic Agreement. The Economic Agreement of 2002 represents a new style of GCC joint work as it does not only call for cooperation and coordination among Member States, but goes beyond that to expressly provide for the economic integration among them through the adoption of specific programs and workable mechanisms.[36]

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[32] Article 4 of the GCC Charter. The Charter signed on 25th of May 1981. Gcc-sg.org (2013) *The Charter 1981*. [Online] available from: http://www.gcc-sg.org/eng/indexfc7a.html?action=Sec-Show&ID=1. [Accessed: 22 September 2013].

[33] Braibanti, R. (1987) The Gulf Cooperation Council: A Comparative Note. In: Sandwick, J.A. (ed.). *The Cooperation Council: Moderation and Stability in an Interdependent World.* United States: Westview Press.

[34] See e.g., Raphaeli, N. (2003) Saudi Arabia: A Brief Guide to Its Politics and Problems. *Middle East Review of International Affairs*. Volume 7. No. 3, 21-22.

[35] See generally, Gcc-sg.org (2013) *Homepage*. [Online] available from: http://www.gcc-sg.org/eng/indexc64c.html?action=GCC. [Accessed: 18 May 2013].

[36] Article 3 of the Economic Agreement. This agreement is a revised version of the Unified Economic Agreements, signed on 1981. Gcc-sg.org. (2004) *The Economic Agreement between the GCC States*. [Online] available from: http://sites.gcc-sg.org/DLibrary/index-eng.php?action=ShowOne& BID=168. [Accessed: 22 October 2013].

Realising the importance of the financial market, the GCC has included this activity to play a major role in the integration of the members' economies. Notably, the word "integration" has been used for the first time in the Economic Agreement of 2002. Article 5 explicitly states that:

> "for the purpose of enhancing local, external, and intra-GCC investment levels, and provide an investment climate characterised by transparency and stability, Member States agree to take the following steps:
> 1. Unify all their investment-related laws and regulations.
> 2. Accord national treatment to all investments owned by GCC natural and legal citizens.
> 3. Integrate financial markets in Member States, and unify all related legislation and policies.
> 4. Adopt unified standards and specifications for all products, according to the Charter of the GCC Standardisation and Metrology Organisation."[37]

In the trade sector, the abolition of internal customs tariffs on regional products was the first major step toward creating a GCC common market thus the GCC free-trade area was established in 1983.[38] The establishment of the common external tariff (CET) was another significant step toward creating a GCC common market. At the same time, the GCC has agreed to the establishment of a range of common institutions aimed at positive integration. In the areas of individuals and capital, the right of unrestricted movement and the freedom to conduct economic activity anywhere in the GCC arena is conferred on GCC nationals. Also, the GCC nationals have been permitted to own and deal with shares in the joint stock companies in the GCC States in accordance with the GCC Council decisions for that purpose.[39]

The GCC Monetary union is ratified by KSA, Kuwait, Qatar and Bahrain. Oman had opted out of it in 2006 and the UAE did so in May 2009. Although on March 15, 2010 the UAE re-iterated that it is committed to the concept of a single currency however the free trade in the region should precede single currency realisation. Riyadh is selected as the location for the monetary council and the future central Bank. Nevertheless, the GCC summit had established a Joint Monetary Council (JMC) which will take necessary steps to issue the GCC single currency. The GCC Monetary Union has thus remained a long term goal to be preceded by monetary and fiscal policies and creation of an effective regional central bank. It

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[37] *Ibid*.

[38] The Supreme Council, in its 23rd Session held in Qatar (December 2002), approved the launch of the customs union of the GCC States as of 1st January 2003. It also approved the procedures and steps recommended for the establishment of the customs union of the GCC States. See Dubaicustoms.gov.ae (2003) *Common Customs Law and Rules of Implemetation and Explanatory Notes*. [Online] available from: www.dubaicustoms.gov.ae/en/.../GCCCommonCustomsLawEnglish.pdf. [Accessed: 17 May 2013]; and Gcc-sg.org. (2003) *Implementation Procedures for the GCC Customs Union*. [Online] available from: http://www.gcc-sg.org/eng/index9038.html. [Accessed: 22 October 2013]. For in depth chronicle view of the GCC achievements related to the economic cooperation between the member states, see Gcc-sg.org (2013) *Economic Cooperation* [Online] available from: http://www.gcc-sg.org/eng/indexbbe3.html?action=Sec-Show&ID=53. [Accessed: 18 May 2013].

[39] The GCC Supreme Council Decision at its (28) session of December 2007 to ensure full equal treatment among GCC citizens in the field of stock ownership and formation of corporations. *Ibid*.

is expected that a full monetary union will indeed take place within at least the next decade or so once all political and financial ramifications have been ironed out.[40]

Generally, under pressure from dwindling oil reserves, plummeting oil prices, and domestic unrest, the GCC members are striving to reduce their dependence on oil/energy revenues. To do so, the GCC nations must both diversify their economies (i.e., expand economic activity into non-energy sectors) and construct a sound financial infrastructure. A thorough examination of the securities markets of the two most prominent members of the GCC, namely, KSA and the UAE cannot take place without first briefly surveying the banking systems of the GCC region.

By the standards of most emerging markets, the stock markets of the GCC are still relatively small in terms of both total capitalisation and number of listed companies.[41] There are a number of reasons which explain the smaller, less developed stock markets of the GCC. One factor is the low level of active investors in the region. Another factor is the comparatively short history of the markets – most have only been open since the mid-1990s. Another factor is their limited scope (e.g., whether they encompass funds, bonds, futures, etc.). There is limited margin trading and no short selling in the Gulf markets except the UAE.[42] OTC derivatives are not available on the GCC exchanges apart from call options that are available in Kuwait and exchange traded derivatives that are listed and traded on the Nasdaq Dubai,[43] in the UAE and the Dubai Gold Commodities Exchange.[44] A final, critical factor is the limitation on foreign investor involvement– especially given the low ratio of domestic shareholders to the general population. While Bahrain allows 100% foreign involvement in some areas, only Oman allows full foreign investor participation.

The performance of the GCC markets has varied considerably over the period 1996 to 2012. During 1996, most markets posted modest growth. By 2012, virtually all markets had shown remarkable signs of significant improvement and enhancement vis-a-vis the other securities markets of the world.[45] Once thought of as relatively undeveloped, backwater types of markets, the markets of the GCC – particularly those of KSA and the UAE– are now considered to be some of the most advanced of the world, even though, comparatively, the number of issues traded in these markets is still relatively small.

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[40] Gcc-sg.org. (2003) *Statute of the Monetary Council & GCC Monetary Union Agreement.* 2010. [Online] available from: http://sites.gcc-sg.org/DLibrary/index-eng.php?action=ShowBooks&SID=31. [Accessed: 22 October 2013].

[41] See Alzahrani, A. & Skerratt, L. (2009) How Markets React to Earnings Announcements in the Absence of Analysts and Institutions: Evidence from the Saudi Market. *Brunel University.* Department of Economics and Finance. Working Paper No 09-40. [Online] available from: http://www.brunel.ac.uk/9379/efwps/0940.pdf. [Accessed: 20 August 2014].

[42] The SCA Board of Directors issued Decision No. (25/R) of 2008 Concerning Margin Trading, and later issued its Decision No. (48) of 2012 Concerning the Regulations as to Short Selling of Securities. See the SCA Rules and Regulations, *supra* note 3.

[43] Nasdaqdubai.com (2013) *NASDAQ Dubai*. [Online] available from: http://www.nasdaqdubai.com. [Accessed: 9 October 2013].

[44] See Chapter Five, *infra*. See also McKinsey & Company (2005) *Developing and Integrating GCC Capital Markets*. Kuwait and Riyadh. Corporation Council For the Arab States of the Gulf Secretariat General. 51.

[45] Amf.org.ae (2013) *Arab Capital Markets*. [Online] available from: http//www.amf.org.ae/performance. [Accessed: 7 March 2014].

The securities markets of the GCC region must also be considered against the backdrop of their policies on foreign trade. By maturing country standards, the GCC nations maintain relatively open and liberal trade regimes. They do not maintain exchange controls nor do they impose trade restrictions on imports. All of the GCC countries are members of the World Trade Organization (WTO).[46] Compared to most of the newly industrialising countries and including the fast-growing Asian economies, the GCC countries have a relatively well-developed basic financial sector infrastructure. Particularly impressive is the stability and health of the banking sector, despite the impact of the aftermath of the onset of the late-2007 world financial near-meltdown on some of these countries.

### 1.3.2 The Kingdom of Saudi Arabia Stock Market.

Stock trading began in KSA in 1935 with the Arabian Automobile Company being the first joint stock company to go public in the country. This company was, however, subsequently liquidated. In 1954, the Arabian Cement Company was made public, and was followed by the privatisation of a number of electricity companies in the 1960s. As well, bonus shares (a scrip dividend) were issued. By 1975 there were 14 public companies. The 1970s were a period of Saudisation of foreign banks operating in the Kingdom. Seven foreign joint ventures banks were Saudised, and their shares were offered to the general public.[47]

The market remained informal, until the early 1980's when the government embarked on a rapid development program. In the oil price boom years between 1980 and 1983, the stock market was driven to a speculative boom that sent trading volume and market prices soaring. In 1984, fearing excessive speculation and volatility in KSA Stock Market, and the possibility of a Kuwait type occurrence,[48] a Ministerial Committee consisting of Ministry of Finance and National Economy, Ministry of Commerce and Saudi Arabia Monetary Agency (SAMA) was formed to regulate and develop the market. In 1985, KSA government placed all stock trading under the supervision and control of SAMA and was additionally charged with the day-to-day regulation of the market. With the aim of improving the regulatory framework, SAMA discontinued the existing broker-based stock trading system and authorised 12 domestic commercial banks to act as brokers.[49] The government also created a company in 1985, the Saudi Share Registration Company (SSRC), for the registration of sales and chose the banks to broker and register shares on behalf of their customers. The company provides central registration facilities for joint stock companies and settles and clears all equity transactions.[50]

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[46] Wto.org (2013) *Homepage*. [Online] available from: http://www.wto.org. [Accessed: 26 March 2013].
[47] Azzam, H. T. (1997) *The Emerging Arab Capital Markets: Investment Opportunities in Relatively Underplayed Markets*. United Kingdom: Kegan Paul International. 141.
[48] For more elaboration on the Kuwaiti crises, see Para. 1.3.3, *infra*.
[49] Decree No. 8/1230 was issued on 11/7/1403 Hijri (H) to regulate stock trading through local commercial banks take effect starting from 1 Rabi' Al- Awal 1405 H 23 November 1984.
[50] See Azzam (1997) '*The Emerging Arab Capital Markets…*', *supra* note 47, at 142.

Although business has fallen on hard times, the market was geared up for a public offering of shares in the state-owned Saudi Basic Industries Corporation (SABIC). That was in line with the government's long-standing commitment to privatise as much of State business as is practical.[51] These moves by the government created a more homogenous market and prices against the adverse effects of speculation, and allowed the public to deal in stocks at about 500 bank branches. It also developed KSA market gradually into a mature financial market.[52]

At that time, KSA had no stock market operating as an independent formal entity, and trading was conducted through an electronic network, i.e., the Electronic Securities Information System "ESIS" that was operated by banks and founded by SAMA in the year 1990. However, the CML provides for the establishment of the Saudi Stock Exchange "Tadawul" as a joint-stock company. The functions of the Stock Exchange are currently operated by Tadawul for trading of securities, clearing and settlements, which was launched in October 2001 and officially replaced ESIS.[53]

The ongoing growth of KSA market demanded additional reforms to be adopted by KSA government in order to keep pace with the stock market development. Therefore, the Capital Market Authority was established by the CML, issued by Royal Decree No. (M/30) of 2003.[54] The CMA is a government organisation with financial, legal and administrative independence. The CMA functions are to regulate and develop KSA capital market. It issues the required rules and regulations for the implementation of the provisions of CM L aimed at creating an appropriate investment environment.[55]

By the end of the year 2007, KSA stock market enjoyed a huge market capitalisation of SR 1,946 billion, which made it one of the world's biggest emerging-market stock exchanges. However, the global meltdown of 2007-2008 saw a sharp fall in Tadawul index and reached its lowest in the past 7-odd years. Yet, in 2013 the total market capitalisation reached US$ 467 billion representing a 25% increase on 2012[56] with Tadawul All Share Index (TASI) closing at 8,500 at the end of 2013.[57] Tadawul facilitates electronic trading in

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[51] Abdul-Hadi, A. S. (1988) *Stock Markets of the Arab World: Trends, Problems and Prospects for Integration*. United Kingdom: Routledge. 49-51. For more information on the state and private sector relationship in KSA, see Malik, M. (1999) The private sector and the state in Saudi Arabia. *PhD Thesis*. Durham University.

[52] Azzam (1997) '*The Emerging Arab Capital Markets…*', *supra* note 47, at 147.

[53] The Saudi Stock Exchange (Tadawul which is trading in Arabic). See Tadawul.com.sa (2013) *Homepage*. [Online] available from: http://www.tadawul.com.sa. [Accessed: 22 October 2013]. For in depth chronicle view of the Saudi Market, see Beach, J. W. (2005) The Saudi Arabian capital market law: a practical study of the creation of law in developing markets. *Stanford Journal of International Law*. Volume 41. Issue 2. 307-55.

[54] See the Capital Market Law No. (M/30) of 2003, *supra* note 2.

[55] Cma.org.sa (2012) about capital market authority. [Online] available from: http://cma.org.sa/En/AboutCMA/Pages/default.aspx. [Accessed: 3 May 2013].

[56] See Tadawul.com.sa (2014) *An Application of the Weak Form of Effeminacy Hypothesis on the Saudi Arabia Stock Market after Tadawul*. 2013. [Online] available from: http://www.tadawul.com.sa/wps/portal/!ut/p/c1/04_SB8K8xLLM9MSSzPy8xBz9CP0os3g_AewIE8TIwP3gDBTA08Tn2Cj4AAvY_dQA30_j_zcVP2CbEdFAHYFg5E!/dl2/d1/L0lDU0ovd0NrQUpvaEEvWUJScDF3ISEvNl9OMENWUkk0MjBHTlA5MElLNkVJSURSMDBRNi9lbg!!/. [Accessed: 6 May 2015].

[57] Arabnews.com (2014) *Saudi share market capitalization reached SR1.75 trillion*. [Online] available from: http://www.arabnews.com/news/502176. [Accessed: 28 January 2014].

shares (settlement T+0) and sukuk/bonds (settlement T+2) but does not conduct a derivative market.[58]

When Tadawul was formed, there were many restrictions on share-dealing and trading by foreigners on KSA stock market. But, in August 2008, the government came out with the news that Tadawul would gradually be opened to foreign investors. Non-Saudi Arabia residents are now allowed to deal and trade on KSA stock market provided they do so with the help of KSA intermediaries.[59]

### 1.3.3 The United Arab Emirates Stock Markets

The success of the first public offering of the National Bank of Dubai in 1963 encouraged investors to incorporate more public companies especially after the unification of the Emirates on the 2nd of December 1971. There were more than 20 public companies at the end of 1976. However, the participants in public offerings were limited generally to the government and the merchant class. Thus, share trading was minimal when compared with Kuwait and Bahrain.[60]

The most significant development during this period was the emergence of Gulf companies founded by Kuwaiti investors under licenses issued, not by the federal authority but by local Emirates governments. Between the years 1976-1984 seventy public companies were formed mostly by Kuwaiti investors in the UAE and this was as a result of the emergence of the Souq Al-Manakh and the Kuwaiti government ban on incorporating public companies, due to the financial crisis in 1977.[61] As Gulf companies appeared and their shares were being traded at the Al Manakh stock exchange in Kuwait, an unofficial stock market began to develop in the UAE. Brokers' offices had been springing up in some of the Emirates since 1979. The Emirate of Sharjah was the pioneer in organised mass share trading through brokers' offices and afterwards more offices were opened in the rest of the Emirates. These offices as a whole were connected to the stock market in Kuwait and subject to its influence. All share trading was not subject to any law or regulation, except in Sharjah as it promulgated a law to regulate brokers.[62] It must be noted that there was no company law that governed these companies and, as previously stated, the licenses were given by local Emirates.[63]

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[58] ('T+0,T+1, T+2…)' Abbreviations that refer to the settlement date of security transactions. The T stands for transaction date, which is the day the transaction takes place. The numbers 0,1, 2 or 3 denote how many days after the transaction date the settlement or the transfer of money and security ownership takes place. See Investopedia.com (2014) *What do T+1, T+2 and T+3 mean?.* [Online] available from: http://www.investopedia.com/ask/answers/03/061303.asp. [Accessed: 28 January 2014].

[59] See later chapters for more details.

[60] Darwiche, F. (1986) *The Gulf Stock Exchange Crash, The Rise and Fall of the Souq Al-Manakh*. United Kingdom: Croom Helm Ltd., 75.

[61] Souq of Al- Manakh is unofficial market that was established in Kuwait in 1978.*Ibid*.

[62] Ruler of Sharjah Ordinance Law No. 1/1981 on Dealers and Stock brokers.

[63] *Ibid*., 79-82. See also Salam, E. S. (2002) *Crisis management in the Arab and international stock exchanges and the continuing development*. United Arab Emirates: Bin Desmal Printing & Publishing, 364-369. [Arabic].

After the collapse of the Souq Al-Manakh[64] a committee was established in the UAE to propose a study for the formation of an official UAE Stock Exchange and in 1984 a Federal Commercial Companies Law was enacted.[65] In the year 1998 the UAE stock market experienced its first stock bubble which resulted in sharp decline in share prices that lasted for the following three years. The total market value of public companies lost over 55% of its value during that period which resulted in huge losses to investors and most importantly caused investors to lose confidence in the stock market for years to come. Some of the problems occurred during the "98 crash" was the lack of transparency by public companies in terms of financial reporting and in terms of board share-dealings. The majority of the studies attributed the cause of the crash to the lack of rules and regulations that governs the industry and the virtually nonexistence of the infrastructure such as stock exchanges clearing, depository systems… etc. The absence of the infrastructure of capital market regulations allowed market participants (brokerage offices, mutual funds, etc.) to conduct unfair trading practices which resulted in harming small investors.[66]

Thereafter, two official stock exchanges, the Dubai Financial Market (DFM)[67] and the Abu Dhabi Securities Exchange (ADX),[68] were formed in the year 2000. Both markets were established as local public establishments having their own independent corporate body. They operate as secondary markets for the trading of securities issued by public shareholding companies, bonds issued by the federal Government or any of the local Governments and public institutions in the country, units of investment funds and any other financial instruments, local or foreign. Clearance and settlement is at (T+2) in both markets.[69]

The DFM was converted into a public joint stock company by an initial public offering in November 2006.DFM offered 1.6 billion shares, representing 20 per cent of its paid-up capital of 8 billion Dirhams. The government of Dubai retained the remaining 80 per cent of DFM Company through Borse Dubai Limited.[70] The initial public offering of DFM shares was hugely oversubscribed with the official DFM website stating that total subscriptions exceeded201 billion Dirhams or the equivalent of US$57 billion.[71] DFM shares commenced trading in March 2007 and the exchange is subjected to all the rules and regulations that applied to listed companies.

The ADX takes the form of a local public establishment owned by the government of Abu Dhabi and based in the capital of the UAE, Abu Dhabi. The Exchange is vested with a

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[64] Deferred-payment transactions and speculative practices proliferated and share traders succumbed completely to make euphoria and indiscipline lead eventually to the collapse Souq of Al- Manakh market. *Ibids*.
[65] See Lexemiratidotnet.wordpress.com (1984) *Federal Law No. 8 of 1984 Concerning Commercial Companies*. [Online] available from: https://lexemiratidotnet.files.wordpress.com/2011/07/federal-law-no-8-of-1984.pdf. [Accessed: 21 April 2012].
[66] See Salam, (2002) '*Crisis management in the Arab*…', *supra* note 63, at 364-369.
[67] Ministry of Economy Decree No. 14/2000 on Dubai Financial Market.
[68] Local Decree No. 3/2000 on Abu Dhabi Securities Market.
[69] For the definition of (T+2) see *supra* note 58.
[70] Dfm.ae (2012) *Homepage*. [Online] available from: http://www.dfm.ae/pages/default.aspx. [Accessed: 20 February 2012].
[71] Dfm.ae (2013) *Overview*. [Online] available from: http://www.dfm.ae/pages/default.aspx?c=801. [Accessed: 1 March 2013].

legal entity of autonomous status, independent finance and management, and has the necessary supervisory and executive powers to exercise its functions.[72] Unlike the DFM, the ADX is not a listed entity and has remained a local entity. The exchange was formerly known as Abu Dhabi Securities Market and changed its name to Abu Dhabi Securities Exchange in May 2008. The ADX has 65 listed companies[73] on its exchange and the DFM has 55 locally established companies as well as foreign entities.[74]

In addition, the UAE government issued Federal Law No. (4) in the year 2000[75] which called for establishing the Emirates Securities & Commodities Authority (SCA) a government entity with the objectives of regulating and developing the capital market.[76] This Law states that the Authority enjoys a legal entity, financial and administrative independence with the control and executive powers necessary for it to discharge its tasks in line with the provisions of this law and the regulations issued in implementation thereof, noting that the authority reports to the minister of economy. The Authority may set up subsidiary branches or offices to discharge the tasks of supervising and monitoring the markets but may neither practice trade activities nor seek benefit in any project nor own or issue any securities.[77]

The UAE is the second largest economy and capital market after Saudi Arabia. The UAE also has the second largest volume of traded shares after Saudi Arabia. As of end-2014, the trading volume was 2,087,124,132 billion Dirhams (US$568210972.054). However, during 2004-2005 there was a substantial increase in share prices and trading activity. Then, towards the end of 2005 through until mid-2006 the bubble burst and the share values dropped by around 60% on DFM and over 30% on ADX like all other GCC markets.[78] As the above indicates, the short but eventful story of the growth of the DFM and ADX has covered dramatic changes over their fifteen year history. Expected forecasts are equally positive especially considering the MSCI re-classification of the UAE from a frontier to an emerging market effective as of mid-2014. The expected benefits of this re-classification are

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72 Adx.ae (2013) *Home*page. [Online] available from: http://www.adx.ae/English/Pages/default.aspx. [Accessed: 18 May 2013].

73 Adx.ae (2014) *listed companies*. [Online] available from: http://www.adx.ae/English/Securities/Pages/ListedCompanies.aspx. [Accessed: 4 July 2014].

74 Dfm.ae (2014) *listed companies*. [Online] available from: https://www.dfm.ae/pages/default.aspx?c=1010. [Accessed: 15 June 2014].

75 Sca.gov.ae (2000) *Federal Law No. (4) of 2000 Concerning Emirates Securities and Commodities Authority and Market*. 29 January 2000 [Online] available from: http://www.sca.gov.ae/English/legalaffairs/LegalLaws/AmendedRules/FEDERAL_LAW4_2000.pdf. [Accessed: 15 January 2012].

76 Afterwards the SCA licensed ADX and DFM for operation. Also, the SCA issued various rules that govern dealing in the stock market. See Sca.gov.ae (2013*) Securities & Commodities Authority*. [Online] available from: http://www.sca.gov.ae. [Accessed: 6 May 2013].

77 Article 2 of the SCA Federal Law No. (4) of 2000 Concerning Emirates Securities, *supra* note 75.

78 See Esm.sca.ae (2014) *Trade History Reports*. [Online] available from: http://esm.sca.ae/English/Reports/Pages/TradeHistory.aspx. [Accessed: 19 November 2014]. See also Shahine, A. (2015) HSBC Cuts GDP Outlook for 13 Oil Exporters as Price Plunges. *Bloomberg*. 19 January 2015. [Online] available from: http://www.bloomberg.com/news/articles/2015-01-19/hsbc-cuts-gdp-outlook-for-13-oil-exporters-from-russia-to-u-a-e. [Accessed: 4 February 2015].

significant. It is hoped that increased international investors in the form of funds will move into the markets and take long positions.[79]

Finally, at the heart of the Dubai International Financial Centre is Nasdaq Dubai,[80] an exchange that is regulated by the Dubai Financial Services Authority.[81] Nasdaq Dubai is the international financial exchange in the Middle East that offers a wide product range. Companies can raise capital through shares, sukuk and bonds. Exchange-traded funds, derivatives, exchange-traded commodities as well as Real Estate Investment Trusts (REITs) can be listed and traded too. The value of trades in 2013 was US $633 million compared to US $508 million in 2012.[82]

## 1.4 Conclusion

This chapter has attempted to provide an account of the securities markets in general looking at factors that affected and shaped those markets. Then it briefly gives a historic overview of the foundations of each market of the three jurisdictions, UK, KSA and the UAE in order to set the background for the subsequent chapters.

Market development depends greatly on sound regulation that deals with setting the infrastructure its own goals and policy objectives. Issues of investment complexity and risks introduce the necessity of disclosure based regulation that helps enhance the allocational function of capital market while limiting unlawful conduct and protecting stakeholders.

[79] Msci.com (2014) *Market Classification*. [Online] available from: http://www.msci.com/products/indices/market_classification.html. [Accessed: 11 August 2014]; and Msci.com (2014) *MSCI United Arab Emirates Index (USD)*. 30 April 2014. [Online] available from: https://www.msci.com/resources/factsheets/index_fact_sheet/msci-uae-index.pdf. [Accessed: 10 May 2015].
[80] Nasdaq Dubai, *supra* note 43.
[81] See Chapter Five, *infra*.
[82] Nasdaqdubai.com (2013) *Annual Review 2013*. [Online] available from: http://www.nasdaqdubai.com/exchange/annual-review-2013. [Accessed: 9 October 2014].

## Chapter Two

## The Goals and Policy Objectives of Securities Regulations

This Chapter discusses the main policy objectives of securities market regulations in general and then elucidates how disclosure based regulatory regimes emerged as a solution to meet the goals of securities regulations as well as contrasts disclosure based regulation with more prescriptive alternative of 'command and control' regime.

### 2.1 Background: Increasing Investment Complexity and New Risks

As globalisation ever increases, the results have included both the availability of a greater range of potential investment opportunities, along with the fact that investors also face an increasingly complex investment environment. A general source of increased investment complexity is that the operations of securities issuers are now more complex than in prior years. As economies develop and the division of labor intensifies, the production of goods and services becomes more specialised, technological, knowledge-intensive, and complex, and thereby more difficult for any individual to fully comprehend. In addition, the increasing dependence of the global economy on knowledge assets has also increased the complexity of the investment decision-making process.[83]

Furthermore, innovations in financial instruments have introduced a vast array of complex derivatives into the financial system. Complex derivatives increase the complexity of the operations of non-financial companies, as they are used to manage risk and engage in other transactions. A result of the combination of globalisation and financial innovation, complexity is at a new level of interdependence in the financial markets, where seemingly isolated events in one market can manifest themselves in unpredictable risks in others.[84]

The combination of complexity, new risks, and global interdependence has led several recent commentators to observe that investment risk has reached a new level of unknowability and uncertainty.[85] The increasing complexity of financial markets means that the return and risk of a company's securities has a less cognizable relationship to the company's activities and the information contained in its financial statements.

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[83] Arewa, O. B. (2006) Measuring and Representing the Knowledge Economy: Accounting for Economic Reality under the Intangibles Paradigm. *Buffalo law Review*. Volume 54(1).
[84] See Hovat, J. (2013) *Return to Order: From a Frenzied Economy to an Organic Christian Society--Where We've Been, How We Got Here, and Where We Need to Go*. United States: York Press; Kolb, R. W. (2010) *Lessons from the Financial Crisis: Causes, Consequences, and Our Economic Future*. United States: Wiley. 65; and Bookstaber, R. (2008) *A Demon of Our Own Design: Markets, Hedge Funds, and the Perils of Financial Innovation*. United States: John Wiley & Sons Inc. 1-6, 144-46. See also Reuters.com (2008) *Ability to Track Risk Has Shrunk "Forever"*. [Online] available from: http://www.reuters.com/article/bondsNews/idUSL04553545200S0107?. [Accessed: 3 April 2014].
[85] *Ibids.*

Mandatory disclosures are thus, and increasingly so, incapable of providing retail investors with readily understandable information about the factors that affect the value of companies' shares. Consequently, it is more expected that an investor may be unsuccessful to fully incorporate the risks involved and make suboptimal investment choices with such information. In this situation, innovative methods of diversification are especially important and regulations need to be conducive to help investors reap the benefits of the market complexity and at the same time attain efficient market levels of protection.[86]

## 2.2 Overview of Disclosure Based Regulation

Over the course of the past several decades, both legislators and regulators have adopted disclosure schemes to accomplish regulatory goals.[87] The promulgators of both laws and rules have turned to information as a regulatory tool because it is politically acceptable and it interferes less with individual choice and with the operation of markets. Mandatory disclosure has become a sort of "regulation-lite" extolled even by those who would ordinarily oppose regulation.[88]

Even as disclosure requirements have become increasingly common and their regulatory goals increasingly ambitious, however, research in psychology and economics has cast doubt on the traditional account of how people process information. Current understanding of heuristic biases and bounded rationality suggests that information may affect behavior in unexpected ways and may not, in some circumstances, affect behavior at all. More troubling, we may not be able to predict how information will affect behavior. Behavioral research also suggests that more information is not necessarily a good thing. Such behavioral research has led to increased calls for changes in the way disclosure-based regulations are used and have caused some to question the very utility of disclosure-based regulation.[89]

The model for the use of disclosure as a regulatory device is the system established by the securities laws of most civilised countries. That system is not perfect, but to the extent it is successful, its success is largely because it operates in a singular environment: a highly developed, relatively efficient market with an enormous support structure of both market and informational intermediaries, in a context in which decision-makers often seek professional advice and make great efforts to be as rational as possible. This environment provides a

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[86] Ellig, J. & Shadab, H. B. (2009) Talking the Talk, or Walking the Walk? Outcome-Based Regulation of Transnational Investment. *New York University Journal of International Law and Politics*. Volume 41. Issue 2. 277.

[87] The earliest instance of a disclosure-like obligation being used as regulation apparently occurred in 1360, when a rule prohibiting the sale of fish in secret replaced a rule setting a fixed price. See Seabourne, G. (2003) *Royal Regulation of Loans and Sales in Medieval: Monkish Superstition and Civil Tyranny*. England: Boydell Press.

[88] *Ibid.* See also Strassel, K. A. (2006) The Weekend Interview with Christopher Cox: Full Disclosure. *Wall Street Journal*. 20th May. [Online] available from: http://online.wsj.com/news/articles/SB114808 119587258464. [Accessed: 18 December 2013].

[89] See, e.g., Ripken, S. K. (2006) The Dangers and Drawbacks of the Disclosure Antidote: Toward a More Substantive Approach to Securities Regulation. *Baylor Law Review*. Volume 58. Issue (1).

mechanism by which disclosed information can reach its audience, affect behavior, and cause a desired result through its operation on a single variable, the price of a security. It is at least doubtful whether disclosure could accomplish similar goals in different circumstances, and there is no reason at all to assume that disclosure could accomplish different goals in different circumstances.[90]

Even though there is a worldwide commitment to the allocational function of capital markets, each country shapes the capital raising process by its own set of mandatory disclosure rules. Thus, although the securities laws of nations share common goals, they vary widely in how they seek to achieve these objectives. Investors, therefore, not only enjoy a choice of investment opportunities, but they also enjoy choice among competing markets, which are distinguished by, among other features, their differing regulatory regimes.[91]For example, baseline disclosure requirements and timelines for offerings and trading in securities in the UK that are regulated by the FCA are different, of those in KSA that are regulated by the CMA, and from those in the UAE that are regulated, principally, by the SCA. Correlatively, each securities regulator's jurisdiction is confined to the borders of the nations in which it is located so that transactions within its jurisdiction are regulated exclusively by its disclosure rules, even though investors and issuers may prefer a different regime.[92] In this way, each securities regulator enjoys a regulatory monopoly over securities transactions within its nation's borders.[93]

To apprise how regulators should respond to the threat that globalisation poses to their regulatory monopolies, we need to understand the overall pricing function of markets. There is a good deal of debate regarding not only whether securities markets are efficient,[94] more fundamentally what the meaning of market efficiency is.[95] This chapter proceeds first on the assumption that security prices are fundamentally efficient, which is to say that investors impound in their trading beliefs respecting the intrinsic value they attach to an

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[90] Pierce, R. J. (2002) *Administrative Law Treatise*. 4th Ed. United States: Aspen Publishers.

[91] Coffee J.C. (2002) Racing Towards the Top?: The Impact of Cross-Listings and Stock Market Competition on International Corporate Governance. *Columbia Law and Economics*. Volume 102. Issue (7). [Online] available from: http://ssrn.com/abstract=315840. [Accessed: 5 June 2013].

[92] See generally, Cox, J. D. (2006) *Securities Regulation: Cases and Materials*. 5th Ed. United States: Aspen Publishers.

[93] IOSCO Principles for Ongoing Disclosure And Material Development Reporting By Listed Entities state: "In spite of the different approaches used, most jurisdictions agree that listed entities should have an ongoing obligation to disclose information that would be material to an investor’s investment decision and that is necessary for full and fair disclosure. IOSCO, while acknowledging the different regulatory approaches taken by various jurisdictions with respect to ongoing disclosure, notes that these different approaches do not preclude agreement on what events should be disclosed in an effective disclosure scheme. It is therefore possible to identify common principles of ongoing disclosure that would facilitate IOSCO members to develop their own disclosure regimes, in the light of their own unique market characteristics." Iosco.org (2013) *Principles for Ongoing Disclosure and Material Development Reporting by Listed Entities*. October 2002. [Online] available from: www.iosco.org/library/pubdocs/pdf/IOSCOPD132.pdf. [Accessed: 11 January 2013].

[94] Stout, L. A. (2003) The Mechanisms of Market Inefficiency: An Introduction to the New Finance. *The Journal of Corporation Law*. Volume 28. Issue 4.

[95] See e.g., Merton, R. C. (1987) A Simple Model of Capital Market Equilibrium with Incomplete Information. *The Journal of Finance*. Volume 42. Issue 3.

additional unit of disclosure.[96] This chapter's initial assumptions are that market forces accurately price the risks posed by a security and that to the extent two securities are similar in all respects except that one security provides an additional unit of disclosure that the investors believe relevant and the other security does not, investors not only distinguish between the two securities but also rationally price the consequences of the differing disclosures made between the two securities. With a market that is so efficient, our comfort level in a regulatory strategy that permits parties to opt for the reporting metrics of their choice -- for example, GAAP or IFRS -- should be influenced by our belief that the security will be accurately priced to reflect the bargain that is struck including the disclosure risk implicit in that bargain.[97]

Simply put, inaccurate securities prices impair the allocational efficiency of capital markets, a central objective of securities regulation.[98] Thus, the securities regulator will consider disclosure requirements that will bring about greater pricing accuracy for securities. Suppose that the baseline disclosure requirements in the above illustration do not include line of business reporting requirements and that if such information were disclosed it would distinguish issuers of one security from those of comparable others.[99] The securities regulator could pursue the objective of improved pricing of securities and allocational efficiency by adopting line of business reporting so that investors are able to distinguish between comparable issuers with the result that after this new information each security trades at its intrinsic value.[100]

There are four well-recognised interrelated objectives sought to be achieved by mandatory disclosure requirements of the securities laws. Each objective reflects the regulator's fear that his intervention is necessary to address a harmful market failure. First, mandatory disclosure is believed necessary to provide investors with information they need to make informed intelligent investment decisions.[101] Stated simply, absent mandatory disclosure requirements, investors will not receive the information they need to assess competing investment opportunities; the information they do receive will vary widely across

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[96] See Rubinstein, M. (1975) Securities Market Efficiency in an Arrow-Debreu Economy. *The American Economic Review*. Volume 65. Issue (5); and Tobin, J. (1984) On the Efficiency of the Financial System. *Lloyds Bank Review*. 1 (July).

[97] Fox M. B. (2004) Measuring Share Price Accuracy. *Berkeley Business Law Journal*. Volume 1. Issue 1.

[98] See Avgouleas, E. (2005) *The Mechanics and Regulation of Market Abuse: A Legal and Economic Analysis.* United Kingdom: Oxford University Press. 81-82; Treynor. J. L. & LeBaron, D. (2004) Insider Trading: Two Comments. *Financial Analysts Journal*. Volume 60. Issue 3. 10, 12; and Grossman, S. J. & Stiglitz, J. E. (1980) On the Impossibility of Informationally Efficient Markets. *The American Economic Review*. Volume 70. No. 3. 393-405.

[99] Berger, P. G. & Hann, R. (2003) The Impact of SFAS No. 131 on Information and Monitoring. *Journal of Accounting Research*. Volume 41. No. (2). 163,164-67.

[100] See French, K. R. & Roll, R. (1986) Stock Return Variances: The Arrival of Information and the Reaction of Traders. *Journal of Financial Economics*. Volume 17. Issue 1. 5-6; and Richard, R. (1988) R2. *The Journal of Finance*. Volume 43. No. 3. 541-566.

[101] See, e.g., Iosco.org (2013) *Objectives and Principles of Securities Regulation.* May 2003. [Online] available from: http:www.iosco.org/library/pubdocs/pdf/IOSCOPD154. [Accessed: 29 October 2013]; and Goshen, Z. & Parchomovsky, G. (2006) The Essential Role of Securities Regulation. *Duke Law Journal*. Volume 55. No. 4. 711-782. [Online] available from: http://scholarship.law.duke.edu/cgi/viewcontent.cgi? article=1279&context= dlj. [Accessed: 17 November 2013].

issuers so that comparability among them is not practicable.[102] A core feature of this objective is comparability among investment choices, at least with respect to choices among securities competing for the investor's funds. Comparability implicates the scope and detail, and to a lesser extent its presentation format, of the information the regulator requires all issuers to disclose.

Second, securities laws seek to enhance the allocational function of capital markets.[103] Adam Smith's invisible hand is believed to operate more effectively if, on the basis of disclosed information, investors can differentiate risk and return relationships among competing opportunities.[104] Mandatory disclosure rules are believed to facilitate allocational efficiency because uniform disclosure will lead to sharper comparative judgments respecting the relation of risk and return. This is described in detail in subsequent Chapters.

Third, mandatory disclosure rules are justified as a useful prophylactic to reduce the frequency and scale of fraudulent offerings and other manipulative practices. The connection between mandatory disclosure rules and manipulative practices is illustrated by the pump-and-dump schemes that plague penny stock markets in jurisdictions such as the United States[105] (at least, in comparison with the three nations under examination here – the United Kingdom, the Kingdom of Saudi Arabia, and the United Arab Emirates). Pump-and-dump can be described as a scheme for public trading in securities of issuers about which there is no reliable public information. This permits the unscrupulous promoter to pique investor interest through rumors and false reports; with large numbers of credulous investors providing upward price momentum for the security, the promoter can dispose of his holdings at a substantial profit. Thus, mandatory disclosure rules fill what otherwise would be an information void that allows the unscrupulous promoter to carry out his fraudulent scheme.

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[102] Sunder, S. (1975) Stock Price and Risk Related to Accounting Changes in Inventory Valuation. *The Accounting Review*. Volume 50. No. 2. 305-315.

[103] See Merritt, B. F. (2001) Company Registration and the Private Placement Exemption. *The Case Western Reserve Law Review*. Volume 51. Issue 3. 455, 458-60; and Durnev, A., Morck, R., & Yeung, B. (2001) Does Firm-Specific Information in Stock Prices Guide Capital Allocation? *The National Bureau of Economic Research*. Working Paper No. 8093. January 2001. [Online] available from: http://www.nber.org/papers/w8093. [Accessed: 28 September 2014].

[104] Adam Smith stated that: "As every individual, therefore, endeavours as much as he can both to employ his capital in the support of domestic industry, and so to direct that industry that its produce may be of the greatest value; every individual necessarily labours to render the annual revenue of the society as great as he can. He generally, indeed, neither intends to promote the public interest, nor knows how much he is promoting it. By preferring the support of domestic to that of foreign industry, he intends only his own security; and by directing that industry in such a manner as its produce may be of the greatest value, he intends only his own gain, and he is in this, as in many other cases, led by an invisible hand to promote an end which was no part of his intention. Nor is it always the worse for the society that it was no part of it. By pursuing his own interest he frequently promotes that of the society more effectually than when he really intends to promote it." See Cannan, E. (ed.) (1977) *An Inquiry into the Nature and Causes of the Wealth of Nations by Adam Smith*. United States: University of Chicago Press. 477-78. For more interpretation of the "Invisible Hand" Theorem, see Basu, K. (2010) *Beyond the Invisible Hand: Groundwork for a New Economics*. United States: Princeton, NJ: Princeton University Press. 25.

[105] See Initiation or Resumption of Quotations Without Specific Information, Exchange Act Rule, 17 C.F.R. § 240.15c2-11 (2008).

Fourth and finally, mandatory disclosure both empowers stockholders vis-a-vis the firm's managers and restrains opportunistic behavior by company managers.[106] Disclosure not only nurtures the managers' responsiveness to their stockholders, certainly in connection with any regulated proxy solicitation, but also can attract a bid for control. Additionally, there is a fear that in the absence of mandatory disclosure managers will time their disclosures so as to maximise gains they can reap through insider dealing.[107] A further concern is that absence of reliable information, managers may calculate a disproportionate value of the firm while going private or other forms of restructuring. By providing information regarding the company's performance and its managers' stewardship in a timely manner, mandatory disclosure rules are believed to reduce the frequency of these ill effects.

As this chapter further examines, most of these objectives are adversely affected if IFRS and GAAP are permitted in a single market. This chapter also seeks to examine the goals and policy objectives which underlie regulatory disclosure systems generally, using the securities laws as a paradigm, in an effort to determine when and how disclosure systems work and to provide guidelines for the use of disclosure by regulators. Included is a discussion of the practical and philosophical reasons for the popularity of disclosure-based regulations.

## 2.3 The Popularity of Disclosure-Based Regulation

There are dozens, possibly hundreds, of regulatory schemes that use disclosure in whole or in part to accomplish their purposes.[108] Regulatory disclosure schemes blossomed in the 1980s as part of a trend to inform and educate rather than regulate. Disclosure-based regulation has both pragmatic and political justifications. First, it comports with the view that command-and-control regulation does not work.[109] Moreover, it is easier to require disclosure than to regulate substantively,[110] which requires identifying desirable and undesirable behaviors, showing them to be beneficial or harmful, showing that the proposed regulation will have the desired effect on the behavior, and showing that the costs of compliance with the regulation and the unintended consequences of the regulation will not outweigh its benefits.[111] Disclosure can be used to regulate even when we are unsure what to

[106] Mahoney, P. G. (1995) Mandatory Disclosure as a Solution to Agency Problems. *The University of Chicago Law Review*. Volume 62. Issue 3. 1047, 1051, 1077-80.
[107] Coffee, J. C. (1984) Market Failure and the Economic Case for a Mandatory Disclosure System. *Virginia Law Review*. Volume 70. No. 4. 717, 739-41.
[108] Graham, M. (2001) *Information as Risk Regulation*. Regulatory Policy Program Working Paper RPP-2001-04. Cambridge, MA: Center for Business and Government, John F. Kennedy School of Government. Harvard University. [Online] available from: http://www.hks.harvard.edu/m-rcbg/research/rpp/RPP-2001-04.pdf. [Accessed: 4 July 2014].
[109] Adler, R. S. & Pittle, R. D. (1984) Cajolery or Command: Are Education Campaigns an Adequate Substitute for Regulation?. *Yale Journal on Regulation*. Volume 1. Issue 2. 159-193.
[110] See Kysar, D. A. (2004) Preferences for Processes: The Process/Product Distinction and the Regulation of Consumer Choice. *Harvard Law Review*. Volume 118. Issue 2. 525-642; and Stephen, B. (1984) *Regulation and Its Reform*. United States: Harvard University Press.
[111] See Stephen (1984) 'R*egulation and Its Reform'*, *ibid.*, 101-09 (describing the standard-setting process); and Karkkainen, B. C. (2001) Information as Environmental Regulation: TRI Performance Benchmarking, Precursor to a New Paradigm?. *Georgetown Law Journal*. Volume 89. Issue 2.

regulate, because the decision about behavior is left to a third party, the target of the disclosure. Also, disclosure moves decision-making away from the government and down to the individual or firm, which often permits more efficient decision-making.[112]

Second, disclosure schemes comport with the prevailing political philosophy in that disclosure preserves individual choice while avoiding direct governmental interference. Disclosure is a "soft" form of intervention that does not directly mandate change in the underlying behavior.[113] In other words, it is a form of civil regulation-regulation by society, not the government. Moreover, disclosure-based regulation appeals to those with a pro-market political orientation because it addresses market failure without disturbing other beneficial features of the market.

In addition, disclosure-based regulation may reflect a changing political dynamic.[114] The insights of public choice theory apply to statutes requiring disclosure as well as to any other kind of statute, and it may be that the increase in regulation by disclosure reflects an improved ability by regulated groups to use the legislative process to avoid direct regulation. Similarly, the adoption of less intrusive disclosure schemes by regulators may reflect increased influence by regulated parties on agency rulemaking.[115]

## 2.4 The Goals of Disclosure Within the Context of Securities Regulation

The purpose and goals of securities regulation are multiple, overlapping, broad, and include the following four principal objectives:

### 2.4.1 Reducing Informational Asymmetries

The purpose of securities disclosure is often stated to be providing more information to investors. Alternatively, the policy can be described as remedying information asymmetries that existed between investors, on the one hand, and issuers and promoters of securities, on the other, before securities laws and regulations first commenced to be adopted.[116] Because information asymmetries cause market participants to demand compensatory premium, a disclosure policy that reduces those asymmetries will improve the price-setting function of the market.[117] Generally, the securities laws and rules are based on

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[112] Karkkainen (2001) *'Information as Environmental Regulation…'*, *ibid*., 293.
[113] Parkinson, J. (2003) Disclosure and Corporate Social and Environmental Performance: Competitiveness and Enterprise in a Broader Social Frame. *The Journal of Corporate Law Studies*. Volume 3. Issue 1.
[114] Wesley, A. M. & Viscusi, W. K. (1992) *Informational Approaches to Regulation*. United States: MIT Press.
[115] See Graham, M. (2002) *Democracy by Disclosure: The Rise of Technopopulism*. United States: Brookings Institution Press (describing industry support for disclosure requirements); and Krawiec, K. D. (2005) Organizational Misconduct: Beyond the Principal-Agent Model. *Florida State University Law Review*. Volume 32. Issue 2. 571, 610-13.
[116] Seligman, J. (1995) The Obsolescence of Wall Street: A Contextual Approach to the Evolving Structure of Federal Securities Regulation. *Michigan Law Review*. Volume 93. Issue 4. Broker-dealer regulation is also directed at informational asymmetries between investors and market professionals. *Ibid*.
[117] Fox, M. B., Morck, R. & Yeung, B. et al. (2003) Law, Share Price Accuracy, and Economic Performance: The New Evidence. *Michigan Law Review*. Volume 102. Issue 3.

the proposition that the independent judgments of buyers and sellers in a securities market will best determine accurate prices for securities if those buyers and sellers have adequate information. Thus, disclosure is essential to the functioning of the capital markets because the most efficient allocation of resources will occur when the information is sufficient for the purposes of those making decisions, when it is reliable, and when it is disseminated in a timely manner. Pricing risk is one of the essential functions of the securities markets, and disclosure of information improves market participants' ability to assess and price risk.[118]

Also, by making information available to all, rather than allowing it to be distributed unevenly to selected market participants in a manner that would be perceived to be unfair, disclosure requirements can increase public confidence in the markets. Mandatory disclosure requirements also ensure that disclosed information is standardised and, therefore, more easily comparable. Finally, disclosure requirements assure investors that additional information will be available on a regular and timely basis.[119]

If the sole objective of securities regulators is facilitating investors' ability to make meaningful comparisons among issuers on the basis of publicly available information, regulators should be reasonably comfortable with mutual recognition in the GAAP-IFRS context, at least if securities are priced in a market that is fundamentally efficient. Investor judgments respecting investment opportunities are at a socially desirable level of acuity if investors can price securities accurately so that any disclosure lacunae of one issuer vis-a-vis another issuer are reflected in a heavier discounting of the price of the former over the latter. Importantly, under the assumption of fundamentally efficient capital markets, the amount of that discount will capture the disclosure risk posed by the lower disclosing firm accurately. Here we can see the strong similarity between the arguments in support of multiple disclosure standards and the longer-lasting debate regarding the social benefits of mandatory disclosure rules. Opponents of mandatory disclosure requirements have argued that mandatory disclosure rules are superfluous or at least impose costs in excess of their benefits.[120]

To such critics, the costs of mandatory disclosure rules are unnecessary because they believe investors in a laissez-faire environment can self-protect through discounting the returns of issuers based on the relative completeness and trustworthiness of their disclosures.[121] It is also argued that those who advocate mandatory disclosure requirements ignore the incentives managers have to disclose information voluntarily. Most recently, the axis of this debate has shifted. Today, critics, while appearing to accept mandatory

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[118] Dally, P. J. (2007) The Use and Misuse of Disclosure as a Regulatory System. *Florida State University Law Review*. Volume 34. Issue 4. 1089-1131.

[119] *Ibid*. See generally Loss, L. & Seligman, J. (1989) *Securities Regulation*. 4th Ed. United States: Aspen Publishers. 133, 171-93 (discussing the debate); Seligman, J. (1983) The Historical Need for a Mandatory Corporate Disclosure System. *The Journal of Corporation Law*. Volume 9. Issue 1; and Hannes, S. (2004) Comparisons Among Firms: (When) Do They Justify Mandatory Disclosure?.*The Journal of Corporation Law*. Volume 29. Issue 4.

[120] *Ibids*.

[121] See Stigler, G. J. (1964) Public Regulation of the Securities Markets. *The Journal of Business*. Volume 37. Issue 2; and Ferrell, A. (2007) Mandatory Disclosure and Stock Returns: Evidence from the Over-the-Counter Market. *The Journal of Legal Studies, The University of Chicago Law School*. Volume 36. Issue 2. 213-251.

disclosure, advocate that issuers should enjoy unrestrained choice of which disclosure regime they will employ to satisfy their disclosure obligations.[122] Thus, we can see there is at best a slender divide between the arguments of those who question the mandatory disclosure rules and those who champion a multiple disclosure standards approach.[123]Such similarity is understandable, even predictable, since, if markets are fundamentally efficient, investors do not need the paternalism provided by the costly mandatory disclosure requirements to price securities appropriately.[124] While the purpose here is not to review the debate on the necessity of mandatory disclosure requirements, it is relevant to place that debate within the context of multiple disclosure standards.

To be sure, in a market that is fundamentally efficient, if the goal is solely to facilitate comparability, the life of the securities regulator would be a quiet one. The classic goal of facilitating informed investment decisions would reduce the regulator to the rather menial task of making sure that issuers disclosed enough information so that investors are aware of the nature of the disclosure differences among issuers. Thus, in evaluating issuers G, G', I, and I', the role of the securities regulator would be to assure that the disclosure differences among the four issuers were adequately discernible so that these pricing differences would occur. By so acting, the regulator can rest assured that at least one of the objectives of securities regulations has been satisfied.

These goals all involve enhancing the function of the securities markets. But the securities regulatory authorities in every regulated jurisdiction, however, also consider it to be their mission to be the protection of investors. Those goals are not the same and may not even be purely complementary. Market efficiency may be enhanced, for example, when investors' mistakes are punished by losses and investors have the opportunity to learn to invest more rationally or to stay out of the market and leave the decision-making to experts.[125] Should securities regulations be designed with those investors in mind, or should securities regulatory authorities be concerned with protecting the non-diversified investor, who may be at greater risk?[126] Also, regulation of different kinds of investments may be directed at different kinds of investors. Hedge fund investors, for example, tend to be wealthy and sophisticated, while mutual fund investors tend to be middle class and unsophisticated.[127] And, as discussed below, the relevant audience for most securities disclosure is not investors

[122] Choi, S. J. & Guzman, A. T. (1998) Portable Reciprocity: Rethinking the International Reach of Securities Regulation. *South California Law Review*. Volume 71. Issue 5. 903-08.
[123] Fox, M. B. (1999) Retaining Mandatory Securities Disclosure: Why Issuer Choice is Not Investor Empowerment, Virginia Law Review, Volume 85. Issue 7. 1335-1419.
[124] See Choi & Guzman (1998) *'Portable Reciprocity…', supra* note 122, at 926 ("Domestic lawmakers ... may place a duty on broker-dealers to notify investors of the law governing transactions in a particular company's securities").
[125] Fisch, J. E. (2006) Regulatory Responses to Investor Irrationality: The Case of the Research Analyst. *Lewis & Clark Law Review*. Volume 10. Issue 1. 57, 74.
[126] See Podcast (2006) *Do the Benefits of Securities Regulation in the United States Warrant the Costs?*. The Section on Securities Regulation. Association of American Law Schools. 4 January 2006. [Online] available from: http://www.aals.org/am2006/program/wednesday.html. [Accessed: 10 May 2014].
[127] Hu, H. T. C (2005) The New Portfolio Society, SEC Mutual Fund Disclosure, and the Public Corporation Model. *Business Law*. Volume 60. Issue 4. 1303, 1307, 1357-58.

at all, but informational and market intermediaries. In sum, the goal of providing information to investors is less straightforward than one might think.

### 2.4.2 Enhancement of the Allocational Function of Capital Markets

The securities regulator contributes to allocation efficiency[128] by mandating lines of business reporting. Now consider the impact of the entry of I and I'. Their presence returns mispricing to the host market because, at least for these two securities, they either will be under-or over-priced.[129] At the same time, both I and I' are riskier than G and G' since their expected value is the combination of their future potential outcomes, which have a greater variance than for G or G'. Investors will not shy away from purchasing either I or I', provided the expectation of accurately identifying which stock is I and reaping a US$1 gain is sufficient compensation for the risk involved in making that investment choice.

To illustrate the connection with allocational efficiency, assume that each of the four issuers will undertake a public offering of 50 million shares. The distribution will therefore result in I' receiving US$50 million more than its match, G'; and I receives US$50 million less than its match, G.[130] The regulator will view the loser in this process as not solely I but the host country's investors who chose I' over the other three investment choices. The regulator has good cause to believe that if all issuers selling securities within its jurisdiction abided by its mandatory disclosure rules that there would have been more accurate pricing of the issued securities and investors could have better maximised their investment return. And, assuming that capital is not unlimited, some issuers may have been able to distribute more of their own securities if there had been a level disclosure field since factors disclosed per GAAP may reflect greater future risks for I and I' than for other capital-hungry issuers.[131]

Accurate securities prices also affect the disciplining effects of the market for control, which has its own impact on the role that securities markets play in the allocation of capital. Mandatory disclosure rules enhance the likelihood that managers who perform poorly by making suboptimal uses of the resources under their control will be displaced. Those who replace them can be expected to better deploy the firm's resources. Thus, if the cause of differences between I and I' issuers is that I firms have talented managers and I' do not, the pricing of I firms so that they are indistinguishable from I' firms will mean I' managers will

[128] Gordon, J. N. & Kornhauser, L. A. (1985) Efficient Markets, Costly Information, and Securities Research. *New York University Law Review*. Volume 60. Issue 5. 761, 767-69.

[129] See Kenneth, R. F. & Richard R. (1986) Stock Return Variances: The Arrival of Information and the Reaction of Traders. *Journal of Financial Economies*. Volume 17 Issue 1. 5-6; and Leuz, C. & Verrecchia, R. E. (2000) The Economic Consequences of Increased Disclosure. *Journal of Accounting Research*. Volume 38. Issue (SUPP.). 91, 93.

[130] A reminder of the earlier stated assumption that share prices are efficiently priced in light of information that is publicly available. Thus, I indeed has an intrinsic value greater than the value embedded in its market price because the market price does not reflect the private information that would call for a higher market valuation.

[131] Fox, M. B. (2000) The Securities Globalization Disclosure Debate. *Washington University Law Quarterly*. Volume 78. Issue 2. 567-1606.

continue to be immune from the disciplining effects of a takeover or proxy contest so that I' firms' resources will continue to be misallocated.[132]

Thus, under a mutual recognition-multiple standards approach, the well-meaning regulator loses its ability to influence the allocation of capital. Even G' Issuers may suffer because investors are attracted to the prospects of the rewards of identifying an I Issuer by the fifty percent odds of acquiring an IFRS reporting firm at US$ 21 that becomes a US$ 22 security. Domestic issuers lose; indeed, all issuers lose if investment funds are diverted to lower disclosing firms. As developed above, the lower disclosing firms pose greater risk, but their greater risk will not prevent them from attracting capital if investors perceive the reward of accurately picking such class issuer. And, the lower disclosing firms' managers also face a reduced likelihood of being disciplined by the market for control.[133] Each effect interferes with the regulators' quest to enhance allocational efficiency in their market.

### 2.4.3 Regulating Unlawful Conduct

Further complicating the picture of the purpose of securities regulation are those who argue that the disclosure requirements of the securities acts are also intended to deter undesirable conduct. Commentators describing the origins of the disclosure requirements of the securities laws and rules frequently quote the American supreme court justice Louis Brandeis, that "[s]unlight is... the best of disinfectants."[134]According to Brandeis, if brokers' fees and commissions are unreasonable, investors will refuse to invest with them and the brokers will change their policies.[135]

The securities regulator's play two roles in deterring fraudulent offerings: *ex ante* through mandating disclosures that makes it impractical for these offerings to take place, and *ex post* by enforcing antifraud provisions that deter others from engaging in fraudulent securities offerings.[136] Embracing dual reporting standards would not adversely impact the securities regulator's role of deterring fraudulent offerings through its enforcement of applicable antifraud provisions. It would seem that the sanctions to be applied would be those of the host country so one could expect that the sting of the enforcement efforts would not be diminished. However, on closer analysis, deterrence will be affected to the extent the principles-based approach of IFRS has the effect of making violations more difficult for regulators to both detect and prosecute successfully. Indeed, those who call for principles-based regulation do so with an equally forceful call that regulation should be prudential, that

[132] See generally, Jill, E. F. (1993) Imprudent Power: Reconsidering U.S. Regulation of Foreign Tender Offers. *Northwestern University Law Review*. Volume 87. Issue 2. 523-25.
[133] Easterbrook, F. H. & Fischel, D. R. (1981) The Proper Role of a Target's Management in Responding to a Tender Offer. *Harvard Law Review*. Volume 94. Issue 6. 1161-64.
[134] Brandeis, L. D. (2014) *Other People's Money and How the Bankers Use It*. 1st Ed. United States: CreateSpace Independent Publishing Platform. 92.
[135] *Ibid.*, 101-04.
[136] Stigler, (1964) *'Public Regulation of the Securities Markets'*, *supra* note 121.

is, not enforcement oriented.[137] Consequently, any substantive ambiguity or weaknesses in IFRS will carry forward to the enforcement actions by the host regulators and will weaken the deterrent effects of its enforcement actions. As a consequence, fraud will occur with greater frequency if issuers can opt for weaker disclosure standards so that the host country is hobbled in deterring the occurrence of fraud because the selected regime's laws provide weaker enforcement procedures and powers than do the host country's laws.

Moreover, the assumption that offerings will be priced efficiently does not protect investors from fraudulent offerings. This pricing assumption assumes disclosure of enough information so that investors can appropriately discount the purchased security by the disclosure risks it presents. Fraudulently offered securities by definition will be indistinguishable from other securities, except that securities opting for more rigorous disclosure regimes pose a lower risk of fraud than those securities choosing a less rigorous disclosure regime. To be sure, investors can be expected to impound in their pricing decisions the average risk of fraud for all securities. Such an averaging, however, is a tricky, and most likely indeterminate, calculation. Theoretically, investors should divide securities according to the disclosure regime each has opted to use and discount each security within the group by the average risk of fraud posed by all securities in that group. So viewed, this risk is systematic so that it cannot be diversified away; the larger and more diverse one's portfolio, the closer the portfolio's overall risk of holding fraudulent offering will be to the risk of fraud in the market as a whole.

The significance of the risk of a fraudulent offering not being a diversifiable risk is that when the well-diversified investor has the misfortune (statistically predictable though it is) to hold a fraudulently offered security that becomes worthless, or nearly so, the investor's loss is not recouped from the other securities in the investor's portfolio. Each of the remaining securities remain subject to the disclosure risks that were embedded in them when the investor acquired them and those disclosure risks will cause them to carry the same discount for their respective disclosure risks when resold by the investor. That is, the result of holding a diversified portfolio is not like squeezing a balloon, where pressure at one spot causes an equal expansion at another location.

This merely reflects the well-recognised principle that the presence of fraudulent offerings that cannot be detected *ex ante* through prevailing disclosure procedures lowers the value of all offerings. At the same time, the risk being systematic does lead to all investors expecting compensation for bearing this risk; thus, the expected return for investors is greater than if this risk were not present. Stated differently, much like the rising tide that lifts all boats, fraudulent offerings that cannot be identified *ex ante* raise the cost of capital for all issuers. This increases the cost of capital for all issuing companies; but when one considers that companies that raise capital by issuing securities compete with other investor opportunities that do not raise funds in securities markets and that involve no risk of

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[137] Committee on Capital Markets Regulation (2007) *The Competitive Position of the U.S. Public Equity Market*. [Online] available from: http://capmktsreg.org/app/uploads/2014/12/The_Competitive_Position_of_the_US_Public_Equity_Market.pdf. [Accessed: 8 June 2013].

managerial oppression, one can also see its effects on the efficient allocation of investment dollars.[138]

The securities regulator seeking to prevent fraudulent securities offerings *ex ante* in a multiple disclosure standards approach faces a very circumscribed agenda. Powerless to regulate substantive disclosures of issuers opting to be governed by another disclosure regime, the most the regulator can hope to accomplish is to inform investors of the greater likelihood of fraud associated with the disclosure regime selected by an issuer. This course is similar to that discussed earlier in terms of the host regulator's task in facilitating the efficient pricing of securities so that differences in disclosure practices are impounded in the security's price. The most that can be accomplished through such generic warnings is to cause each purchased security to be priced at an amount that reflects the average risk of fraud among securities opting for that particular disclosure regime. But as seen above, even so discounted, if the investor experiences a loss from a fraudulent offering, the magnitude of that loss is not offset by discounts for the other securities in the investor's portfolio.[139]

### 2.4.4 The Empowerment of Stockholders Vis-a-Vis Firm Managers

Mandatory disclosure rules are also a central component of corporate governance. For example, proxy voting for public corporations is conditioned upon the proxy solicitor making extensive disclosure of information germane to shareholders exercising informed decisions when executing their proxies. Absent such disclosures, shareholders would be left to the vagaries of fiduciary-based disclosure duties of directors and controlling stockholders.[140] Governmental disclosure requirements overcome these weaknesses so that managers approach the proxy season with a healthy understanding that their stewardship in the prior fiscal period must be adequately disclosed in their proxy materials. Among the disclosures compelled by any meaningful filing requirement are detailed revelations regarding various self-dealing transactions between the corporation and its promoters, managers, or controlling stockholders, including extensive information regarding executive compensation. The securities laws' requirement that the annual financial statements be independently audited is a further effort to provide owners with a neutral perspective of management's stewardship. In this way, many of the disclosures required to accompany management's proxy solicitation materials mirror disclosures mandated by the home country's periodic disclosure requirements.[141]

A major objective of periodic disclosure requirements is to overcome the fear that, absent such mandated disclosures, financially important information would not be released

[138] Cox, J. D. (1986) Insider Trading and Contracting: A Critical Response to the "Chicago School." *Duke Law Journal*. Volume 9. Issue 4. 628, 635-42.

[139] Cox, J. D. (2002) The Death of the Securities Regulator: Globalization. *Berkeley Program in Law and Economics, Working Paper Series*. (Draft March 18, 2002), 20. [Online] available from: http://escholarship.org/uc/item/7sc9w7t0. [Accessed: 8 June 2013].

[140] See generally, Cox, J. D. & Hazen, T. L. (2002) *Cox & Hazen on Corporations*. 2nd Ed. United States: Aspen Publishers. 542-45.

[141] Cox, J. D. (2002)*'The Death of the Securities Regulator…', supra* note 139, at 20-21.

until the managers had reaped for themselves the financial benefits of that information by trading in their company's securities before releasing the information. Without adequate disclosure of information bearing on the value of the firm, managers can, through self-dealing transactions and going private transactions, abuse their insider positions by capturing a disproportionate share of any undisclosed future gains of the firm.[142] To the extent that IFRS results in greater price inaccuracy than is the case for issuers complying with GAAP, does this necessarily compromise the securities regulator's role in addressing managerial opportunism?

Allowing issuers to report their financial performance and position in accordance with IFRS rather than GAAP would not obviate the extensive disclosures public companies must satisfy that are directed specifically toward transactions rife with opportunities for managerial opportunism. Not only would registrants still have to provide extensive information for various self-dealing transactions, but they would also have to comply with requirements for the company to have an independent auditor review the financial statements and under the watchful eye of an audit committee staffed with directors free of financial links to the firm's management. In combination, these requirements provide an important firewall between the firm's assets and temptations managers may have to appropriate to themselves any portion of the firm's value that is not otherwise known. Nonetheless, permitting managers to opt for disclosure standards understood to provide them with greater discretion in the timing of revenues and expenses and the measurement of assets and liabilities provides serious temptations for those inclined to act opportunistically. Simply stated, the greater the price inaccuracy permitted by a disclosure regime, the greater will be the temptations for managers to use the inaccuracies to their advantage.[143]

Finally, it is worth mentioning that transnational trading in securities has (since the mid-1980s) resulted in the development of international regulatory agencies working at achieving common standards in areas such as international equity offerings and international capital adequacy. The work of the International Organization of Securities Commissions (IOSCO), established in 1986 with its membership comprising official securities markets' regulators from developed and developing countries, has been a milestone in achieving the above objectives. In this respect, the IOSCO also strives to enhance the international integration (and harmonisation) of domestic securities markets, and to be a forum for technical exchange and cooperation among members.[144]

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[142] Bernard, S. B. (2001) The Legal and Institutional Preconditions for Strong Securities Markets. *UCLA Law Review*. Volume 48. No. 4. 781-855.

[143] Keay, A. (2014) Comply or explain in corporate governance codes: in need of greater regulatory oversight. *Legal Studies*. Volume 34. Issue 2. 279–304.

[144] In 2014, the IOSCO membership included 124 Ordinary Members of securities regulators, 12 Associate Members, consisting of other financial supervisors and 64 Affiliate Members, including stock exchanges, clearing agencies, ISMA and the European Commission. The UK (FCA), the Kingdom of Saudi Arabia (CMA), and the UAE (SCA) are on the IOSCO Ordinary member list. See Iosco.org (2013) *IOSCO Membership*. [Online] available from: www.iosco.org/about/?subsection=membership&memid=1. [Accessed: 29 October 2013].

## 2.5 Conclusion

This Chapter had indicated the Four Prime Objectives of securities market regulations, namely, (i) reducing informational asymmetries, (ii) enhancing the allocation function of capital markets, (iii) deterring fraudulent offerings of securities, and (iv) insuring that investors are not being taken advantage of by unscrupulous members of management of the companies in which they invest.

The next three chapters will give a practical overview of the regulatory systems in the three sample countries. The companies laws and their historical evolution to deal with contemporary issues will be laid out to detail the issue of stakeholders protection. The securities laws and financial markets and services acts will detail the issue of capital market allocational efficiency. Other relevant regulations will be discussed to develop the issue of deterring fraudulent activities in markets.

## Chapter Three

## The Regulatory Environment within the United Kingdom

This Chapter traces the evolution of the legal framework concerning securities regulation in the UK and describes the aspects which are compared in later Chapters with the legal framework of KSA and the UAE markets.

### 3.1 Regulation of Securities and Issuers by Law: Historical Evolution.

#### 3 .1 .1 The Companies Act of 1985.

The commencement of any discussion regarding the Companies Act of 1985 (the "1985 Act") must be prefaced with the observation that, for the most part, most portions of the 1985 Act have subsequently been repealed,[145] and replaced by the Companies Act of 2006 (the "2006 Act").[146] The conversation which immediately follows should accordingly be read more in the light of being important because of the modifications to it which were brought about by the adoption and implementation of the 2006 Act, and relevant as a backdrop to how matters later developed in this area of the law, than it should as any sort of guide to the manner in which the regulatory scheme in this area formerly applied while the 1985 Act remained in effect. The 1985 Act, which went into effect on 11 March 1985, was by its own terms "An Act to consolidate the greater part of the Companies Acts." [147] This referred to the fact that prior to the adoption of the 1985 Act; companies domiciled within the UK were subject to various other pieces of company legislation that had accumulated on the statute books over the years.

In light of the fact that the 1985 Act has, for the most part, been superseded by the provisions of the 2006 Act, the discussion which follows is structured in the form of an illustration which demonstrates what the former provisions of the 1985 Act were, and showcases their relative importance or unimportance by comparing and contrasting the changes which the 2006 Act brought into existence. The 2006 Act has the distinction of

[145] Certain aspects of the 1985 Act have not been replaced by the 2006 Act, and they continue to remain in force and effect. These include, more particularly, (i) company investigations; (ii) orders imposing restrictions on shares following an investigation; and (iii) Scottish floating charges and receivers. See, The National Archives (2013) *Department for Business Enterprise & Regulatory Reform*. Better Business Framework -- Companies Act 2006.

[146] For a table that shows when each section of the 1985 Act was repealed by the 2006 Act, see Ukpracticallaw.com (2013) *Companies Act 1985: When was it repealed?*. [Online] available from: http://uk.practicallaw.com/9-366-4987?service=dispute#. [Accessed: 29 June 2013]. To check when a particular section of the 2006 Act came into force, seeUkpracticallaw.com (2013) *Companies Act 2006 - When did it come into force?*. [Online] available from http://uk.practicallaw.com/0-370-8957?service=corporate. [Accessed: 29 June 2013]. The 2006 Act, which received Royal Assent on 8 November 2006, was scheduled so as to take effect in stages, which commenced between the date of Royal Assent and concluded on 1 October 2009. See extended discussion, *infra*.

[147] Preamble, Companies Act of 1985.

being the single most lengthy item of legislation ever to be adopted in the entire history of the UK Parliament.[148]

The discussion which follows will highlight the significant provisions of the former 1985 Act by elaborating on the individual provisions of the 2006 Act which replaced and superseded them.

#### 3.1.1.1 Changes Effective as of January, 2007

In the changes from the prior 1985 Act that came into effect as of January, 2007 under the new 2006 Act, the following requirements and standards were imposed:

First, provisions in the 2006 Act which give effect to then-recent amendments to the First Company Law Directive came into force and effect. These changes were in large part designed to ensure increased facilities for e-communications with the national registrar of companies. Additionally, the following provisions linked to implementation of the Transparency Obligations Directive commenced:

- Provisions on company communications to shareholders and others, which include provisions facilitating electronic communication;
- Provisions concerning a public company's right to investigate who has an interest in its shares;
- And, new Section 463, which sets out a statutory basis of directors' liability to the company in relation to the directors' report (including the business review), the directors' remuneration report, and any summary financial statement derived from such reports.

Also, all powers to make orders or regulations by statutory instrument commenced with effect from 20 January 2007. Further, from 1 January 2007, the 1985 Act was amended in order to require the company's name of each company subject to the Act to appear legibly within:

- All of its business letters;
- All of its notices and other official publications;
- On all of its Internet websites;
- All bills of exchange, promissory notes, endorsements, cheques, and orders for money or goods purporting to be signed by or on behalf of the company; and
- All bills of parcels, invoices, receipts, and letters of credit.

[148] Grunberg & Company (2013) *Chartered Accountants*. [Online] available from: http://www.grunberg.co.uk/content/companies_act/key_changes.html. [Accessed: 28 November 2013].

In addition, the company's business letters, order forms, and Internet websites now, under the new 2006 Act, must include fuller particulars than had been required under the prior 1985 Act. More specifically, these additional items of information include:

- The company's place of registration and the number with which it is registered;
- The address of its registered office;
- In the case of an investment company, the fact that it is such a company; and
- In the case of a limited company exempt from the obligation to use the word "limited" as part of its name, the fact that it is a limited company.

All of these new requirements apply whether the document is in hard copy, electronic, or any other form. As can be readily discerned from the foregoing requirements, one of the seminal functions of the 2006 Act was to recognise the vast amount of transformation that the entire world has undergone due to the unrelenting march of technological innovation. Particularly new developments in the area of electronics and, more specifically, computerisation on a mass scale, which in turn have radically altered the manner in which people of all nations now communicate with one another (using such now-commonplace mechanisms as commercial and personal e-mail), a breakthrough which, at the time of the original framing of the 1985 Act, was still the stuff of science fiction.[149]

#### 3.1.1.2.1 Changes Effective as of 6 April 2007

In the changes from the prior 1985 Act that came into effect as of 6 April 2007 under the new 2006 Act, the following requirements and standards were imposed:

- New Section 1063 came into effect, which relates to fees payable to the registrar of companies; and
- Section 1281 of the 2006 Act became effective, which amended Part 9 of the Enterprise Act 2002[150] to give the Secretary of State the power to make an order enabling public authorities to disclose information to be used in civil proceedings or otherwise for the purpose of establishing, enforcing, or defending legal rights.

[149] The origins of the Internet reach back to research commissioned by the United States government in the 1960s to build robust, fault-tolerant communication via computer networks. The funding of a new U.S. backbone by the National Science Foundation in the 1980s, as well as private funding for other commercial backbones, led to worldwide participation in the development of new networking technologies, and the merger of many networks. The commercialisation of what was by the early-to-mid-1990s an international network resulted in its popularisation and incorporation into virtually every aspect of modern human life. As of June 2012, more than 2.4 billion people -- over a third of the world's human population -- have used the services of the Internet. See World Stats (2012) Internet World Stats. *Miniwatts Marketing Group*. 30 June 2012. [Online] available from: http://www.internetworldstats.com/stats.htm. [Accessed: 30 November 2012].

[150] Legislation.gov.uk (2002) *Enterprise Act 2002*. [Online] available from: http://www.legislation.gov.uk/ukpga/2002/40/contents. [Accessed: 2 December 2012].

#### 3.1.1.3 Changes Effective as of 1 October 2007

Speaking in general, non-technical terms, these changes as promulgated through the mechanism of the 2006 Act effectively implemented two major, significant departures from the rules that had governed affected companies under the prior regime of the 1985 Act. These two most noteworthy modifications were:

- For the first time, directors' responsibilities to their companies were specifically prescribed by statutory authority, rather than, as had been the prior practice, relying merely on English common law.[151] English common law has ancient historical roots.[152] The 2006 Act represented a hugely significant evolution in the area of directors' duties and responsibilities; and

- Annual general meeting requirements were modified from the 1985 Act for publicly-traded companies. Further, in recognition of the realities of daily life within the confines of small family businesses and closely-held corporations, the 2006 Act allows private companies to conduct most of their business without the necessity of holding a general meeting.

Viewed from a more technical, legalistic vantage point, the changes that became effective as of 1 October 2007 under the 2006 Act encompassed several different areas.[153]

#### 3.1.1.4 Changes Effective as of 6 April 2008

In the changes from the prior 1985 Act that came into effect as of 6 April 2008 under the new 2006 Act, the following requirements and standards were either newly-imposed, or modified from what had been the requirements under the former 1985 Act. As in the foregoing discussion concerning changes that became effective as of 1 October 2007, the alterations implemented effective 6 April 2008 as a result of the enactment of the 2006 Act can be broken down into two separate categories, namely, substantively significant changes, and changes which are only of technical significance.[154] But in the case of the 6 April 2008

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[151] The Common law was established by the Normans and developed in the territories of Great Britain. Common law, also known as case law or precedent, is law developed by judges through decisions of courts and similar tribunals, as opposed to Civil (Codified/Continental) Law as established by statutes adopted through the legislative/parliamentary process and/or regulations issued by the executive branch on the basis of the parliamentary statutes. It is thus a 'judge-made' law. Generally, see Powel, E. J. & Mitchell, S. M. (2007) The International Court of Justice and the World's Three Legal Systems. *The Journal of Politics*. Volume 69. No. (2). 397-99.

[152] In the late 800s, Alfred the Great assembled the Doom Book, which collected the existing laws of Kent, Wessex, and Mercia, and attempted to blend in the Mosaic code, Christian principles, and Germanic customs dating back as far as the fifth century. Later English common law is traceable to this initial undertaking of some twelve hundred years ago.

[153] The above changes in the Companies Act of 2006 were related to the following parts: (9, 10, 11, 13, 14, 15, 29, 30 & 32).

[154] This is not to necessarily say that all changes labeled in the discussion herein as being merely "technical" or "non-substantive" could not be of major importance given a particular company's individualised set of circumstances or transactions. New Part 27 of the 2006 Act, for example, which became effective 6 April 2008, deals with mergers and divisions of publicly-traded companies. Obviously, to a public company in the process of merging, or in the process of being divided through a "spin-off," "split-off," "split-up," or other form of a

changes, even those which can fairly be categorised as "substantive" are of relatively little import. On this front – the substantively significant changes -- the 6 April 2008 modifications introduced a total of three. These were:

- Shareholders may, for the first time, agree to a limitation on the company's auditor's liability in connection with such auditor's services with respect to the certification of the company's accounts. Needless to say, as soon as this provision came into operation, virtually every accounting firm in the UK immediately tacked on an amendment to its standard engagement letter, and sought shareholder approval of the limitation on liability that it contained at the earliest opportunity.[155]

- The period for filing accounts was reduced from the previous ten months down to nine months; and

- The position of Company Secretary became an optional appointment, whereas previously, it had been a mandatory position.

The nature of these changes, and the ability to call them "substantive," merely highlights the fact that the balance of the changes which became effective as of 6 April 2008 were very non-substantive, and merely technical in nature.[156]

#### 3.1.1.5 Changes Effective as of 1 October 2009

Finally, in the changes from the prior 1985 Act that came into effect as of 1 October 2009 under the new 2006 Act, there were both key, substantively important modifications from the prior law as well as new requirements and standards of a technical nature. The key, or substantive, changes effective 1 October 2009 – that can more properly be categorised into the "technical" column- included the following:

- An easier, much more "user-friendly" approach to the formation and administration of new companies.

- The concept of authorised share capital was abolished.

- Company directors were allowed to file a "service address" in lieu of their personal home address with the company regulatory authority.

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corporate division transaction, new Part 27 of the 2006 Act could prove to be both highly relevant as well as potentially highly significant. Those transactions that are discussed herein as falling into the category of "substantive" are so articulated because they fall into one or both of the following descriptions: They are applicable to every company, irrespective of circumstances, governed by the new 2006 Act, and/or they represent a departure from prior law as it had been codified under the 1985 Act.

[155] In practice shareholders declined to give approval and this was a very contentious step introduced through the back door after very heavy lobbying by auditors. There has subsequently been a major revision at the European level of the regulation of auditors in which liability did not feature because the backdrop was more hostile to them, namely their failure to spot and react to the forces that led to the banking crisis.

[156] Some examples of such technical changes included the following part (12) Company secretaries, (15) Accounts and reports, (16) Company audits, and (20) Private and public companies.

- A right to challenge company names was set out; and
- A company is now, for the first time, permitted to lend financial assistance in connection with the purchase and acquisition of its own shares.

In practical terms, the 1985 Act has, in nearly every respect, been wiped out from the UK legal history, since virtually all of its provisions have been effectively amended and superseded by the terms of the 2006 Act. The adoption by Parliament of the 2006 Act represented recognition by the framers of that legislation that since the time of promulgation of the 1985 Act, the whole world had changed, and changed drastically, and an effort to bring modern UK company law into conformity with the realities of this newly-changed, and globalised economy.

### 3.1.2 Financial Services Act of 1986.

As in the case of the 1985 Act, the Financial Services Act of 1986 (the "1986 Act") is now largely of only historic interest, since it was extensively amended, and effectively superseded, by later legislation.[157] Nevertheless, a brief discussion of the 1986 Act should be useful in order to put later developments in market regulation into proper background context.

The 1986 Act concerned the regulation of investment markets. The objectives of the Act were to regulate the conduct of the business of investment, as well as to increase customer confidence as well as the level of competition within these markets. The 1986 Act used a combination of governmental regulation combined together with self-regulation by various "players" within the investment industry. Among other things, the 1986 Act established an investor compensation fund for aggrieved investors who had lost money in the markets as a consequence of misfeasance or malfeasance on the part of certain other market participants. It also established the Securities and Investments Board (the "SIB")[158]for the purpose of regulating all investment markets (except Lloyds of London) through the mechanism of self-regulatory organisations (SROs).[159]

The 1986 Act was, at the time of its adoption, referred to by many within the investment industry and the ancillary service industries which acted to assist and advise this industry (e.g., law firms and accounting firms) as an "emasculated Gower," or sometimes as "Gower Lite." The reasons underlying these characterisations referred to the fact that Professor LCB Gower[160] had been asked to produce a report on financial regulations,

[157] From midnight of 30 November 2001, the date commonly known within the UK investment industry as 'N2', the Financial Services Authority ("FSA") adopted the full powers given to it by the passing of the Financial Services and Markets Act of 2000 ("FSMA").
[158] The SIB was subsequently replaced by the Financial Services Authority.
[159] Some of the SROs that were established under the 1986 Act included: the Securities and Futures Authority (SFA); and the Investment Management Regulatory Organisation (IMRO).
[160] Cassel Professor of Commercial Law at the University of London and sometime visiting Professor at Harvard University. He is best known for his work in UK company law, where he authored the leading treatise,

followed by a draft bill. He tended to personally favor a strict, enhanced regulatory scheme with a substantial role for government far in excess of the role accorded SROs. The Margaret Thatcher government, in power at the time adoption of the 1986 Act was under active consideration, became frustrated with the extended debate that Professor Gower's proposals had engendered, and actively advocated in favor of an alternative, second proposed Act, the contents of which adopted many of Professor Gower's ideas, but which placed substantially more emphasis on self-regulation over outright governmental intervention.[161] Although the degree to which trans-Atlantic political winds may have had some effect on the way the 1986 Act ultimately favored self-regulation over regulatory intervention by UK governmental authorities is debatable, it has been observed by at least one commentator that the relatively light emphasis on government regulation vis-à-vis industry self-regulation – an indisputable fact when the 1986 Act is considered on the whole – this approach to regulation did in fact follow a similar trend that was simultaneously taking place in America under the archetypically conservative administration of Ronald Reagan.[162]

### 3.1.3 Financial Services and Markets Act of 2000 (FSMA).[163]

As previously indicated, the 1986 Act was replaced and superseded by the later adoption of the FSMA, which received Royal Assent on 14 June 2000, following which FSMA was brought into force at midnight on 30 November 2001, commonly known at the time as N2.[164] As in the case of the prior discussions relating to the 1985 Act and the 1986 Act, it is important to note at the outset that the discourse which follows has now become largely academic, and is principally of interest only for its historical value as well as for the background perspective that it lends for the purpose of analysing later, superseding legislative developments. More particularly, FSMA has now been largely superseded and replaced by the newly-minted provisions of the Financial Services Act of 2012 (the "2012 Act"), most of the effective provisions of which only recently came into effect and operation as of 1 April 2013.

The express purpose of the FSMA was to provide a statutory framework within which a single governmental regulatory authority for the financial services industry, the FSA, would operate. It provided the FSA with a full range of statutory powers, and created the Financial Services and Markets Tribunal (FSMT). The FSMA also established the framework for the existence of a single ombudsman, as well as compensation programs to provide further protection for aggrieved consumers who, through the fault of one or more other market participants, had suffered investment losses.

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now taken over by Davies, P. & Worthington, S. (eds.) (2008) *Gower and Davies: Principles of Modern Company Law*. 8th Ed. United Kingdom: Sweet & Maxwell.

[161] Rider, B., Chaikin, D. & Abrams, C. (1987) *Guide to the Financial Service Act 1986*. United Kingdom: Commerce Clearing House.

[162] Krugman, P. (2009) Reagan Did It. *New York Times*. 31 May 2009. [Online] available from: http://www.nytimes.com/2009/06/01/opinion/01krugman.html?_r=0. [Accessed: 12 May 2013].

[163] Legislation.gov.uk (2000) *Financial Services and Markets Act 2000*. [Online] available from: http://www.legislation.gov.uk/ukpga/2000/8/contents. [Accessed: 25 January 2012].

[164] For N2 meaning, see *supra* note 157.

Under the FSMA, the jurisdiction of the FSA was made to extend to various and wide-ranging aspects of the businesses of investment, banking, insurance, and even a micro-issue as small as the manner in which pensions are to be divided in cases involving marital dissolution. Thus, in comparison with the regulatory schemes that had preceded it, the adoption of FSMA created a new primary regulator – FSA – with a substantially enhanced reach in terms of the areas of business over which it was conferred jurisdiction.[165]

The goals and objectives of the FSA as specified under FSMA have already been previously discussed. The effect of FSMA has been to establish the FSA as a sort of "super-regulator," intended to completely replace the previously-established SROs (which were each abolished as of the effective date of FSMA). Further, FSMA replaced the former two-tier regulatory scheme – which consisted of some governmental regulation, mixed in with some industry self-regulation – as established under the 1986 Act with a single, integrated regime together with a single regulator, namely, the FSA. During its first phase of implementation, FSMA reproduced and updated the then-existing rulebook for regulation, and during the subsequent second phase, the agency introduced a completely new set of regulatory features.

FSMA further created the market abuse administration that applied to members of the public as well as to regulated individuals. In addition to establishing the FSMT, the FSA also created a financial promotion framework under which prohibitions on persons from communicating the details of certain financial activities were imposed. Also under FSMA, the FSA appointed individuals within regulated firms to be registered with the FSA as "approved persons." Unlike under the previously-existing regulatory scheme that had been in place under the 1986 Act, FSMA replaced and updated that approach to provide that professional firms that carry on mainstream financial activity would be regulated directly by the FSA (rather than by the previously-existing SROs). "Mainstream financial activity" was defined to include direct advice to clients on the choice of investment products, discretionary investment management, and certain types of corporate finance activities such as listings and public offers.[166]

For regulated activity under the FSMA, a professional firm wishing to provide mainstream financial services was required to achieve authorisation from the FSA. Subsequent to its receipt of such authorisation, the firm would be regulated by the FSA and would be required to comply with the FSA's Handbook of Rules and Guidance. FSMA for the first time introduced the concept of Regulated Activities Orders (RAOs). An RAO contained a list of regulated activities, and was promulgated using guidance provided by the

[165] The Bank of England Act 1998 transferred its responsibilities for supervising the banking system to the FSA. See Deutche, B. (2006) Securities Market Regulation: International Approaches. *Monthly Report of the Deutsche Bundesbank*. Volume 58. Issue 1. 44.

[166] If a professional firm did not conduct mainstream financial activity they could, under Section 327 of FSMA, be designated an exempt professional firm and could then be supervised and regulated by a designated professional body (DPB) rather than by the FSA. However, they were required to comply with their appropriate, applicable DPB restricted activities rules, the exemptions within the regulated activities order, and the non-exempt activities order as promulgated by HM Treasury.

definitive list of regulated activities that was contained in the Regulated Activities Order[167] as specified by the HM Treasury.[168]

Within the RAO there were a number of exclusions and activities carried on within the foregoing parameters that were not considered to be regulated activity. Thus, exempt professional firms, as with other firms that were not authorised, were able to carry on business within the terms of the exclusions without breaching the general prohibition. Under Section 19 of the FSMA, there existed a general prohibition providing that no person could carry on a regulated activity within the UK, or purport to do so, unless he was either an "authorised person" or an "exempt person." [169]

Under Section 24(1) of the FSMA, it constituted a criminal offence for a person to describe himself or herself as an authorised person if he was in point of fact not such a person. The disclosure rules thus required an exempt professional firm to avoid any representation to its clients that it was authorised by the FSA or that the regulatory protection offered by the FSMA would apply.

## 3.2 The New Frontier: The Financial Services Act of 2012.[170]

### 3.2.1 The Reasons for Adoption of the 2012 Act and the UK Shift from "Integrated" to "Twin Peaks" system.

The Financial Services Act of 2012 (the "2012 Act") is one of the most significant, far-reaching items of securities regulatory legislation to ever successfully pass through the UK Parliament. Just when everybody thought they had finally gotten it right the last time around.[171]

[167] Under the above RAO, "regulated activities" were defined as including activities encompassed by each of the following: a deposit; stocks and shares; instruments providing entitlement to investment (s); units in a collective investment scheme; rights under stakeholder pensions; instruments creating or acknowledging indebtedness (e.g., bonds, stock loans, and debentures); rights under a contract of insurance; futures and options; funeral contracts; rights to or interests in investments; regulated mortgage contracts;Lloyds of London syndicate capacity and membership; government and public securities (except certain stock loans, e.g., National Savings Certificates); and contracts for differences.

[168] Her Majesty's Treasury (HM Treasury), sometimes referred to as the Exchequer, or more informally the Treasury, is the government's economic and finance ministry, maintaining control over public spending, setting the direction of the UK's economic policy and working to achieve strong and sustainable economic growth. For more information, see HM Treasury (2012) *Homepage*. [Online] available from: https://www.gov.uk/government/organisations/hm-treasury. [Accessed: 15 March 2012].

[169] Part II, Article 19 of the FSMA 2000, *supra* note 163. Areas where this general prohibition applied were: effecting and carrying out contracts of insurance; acting as a stakeholder pension plan manager; advising a person to become a member of a Lloyds of London syndicate; establishing a collective investment scheme; entering into as lender, or administering, a regulated mortgage contract; establishing a stakeholder pension scheme; acting as a managing agent at Lloyds of London; market making and dealing in the same way as a stockbroker; entering into broker fund arrangements; and entering as a provider of a funeral plan arrangement.

[170] Legislation.gov.uk (2012) *Financial Services Act 2012*. [Online] available from: http://www.legislation.gov.uk/ukpga/2012/21/contents/enacted. [Accessed: 1 October 2014].

[171] Ferran, E. & Goodhart, C. E. (2001) *Regulating Financial Services and Markets in the 21st Century*. United Kingdom: Hart Publishing.

As the worst global recession since the Great Depression of the 1930s, which officially kicked off in December, 2007 and the effects of which are still being acutely felt even today throughout many parts of the world, brought along with it many clarion calls for reform: Reform of banks, many of which had to be bailed out by their host governments at vast expense to the taxpayer; reform of society in general, in what began in the United States as the "Occupy Wall Street" movement and then proceeded to spread into many other sectors; reform of political systems, as in the "Arab Spring" that saw successful revolts against national governments in Tunisia, Libya, and Egypt, along with the outbreak of civil war within Syria; and finally, reform within the securities markets, which had of late featured literally dozens of scandals, from the Barnard Madoff Ponzi scheme and the meltdown of Enron Corporation within the United States; to the PPI (payment protection insurance), LIBOR rigging,[172] Standard Chartered breach of US sanctions against Iran, HSBC's conviction for money laundering in Mexico, and scandals around sales of interest rate hedging products by several UK banks.

Of the many calls for reform, one that was heard loud and clear by the UK Parliament was for reorganisation of the way in which the UK securities markets are regulated – despite the fact that the legislation that had originally founded the FSA was barely a dozen years old. Therefore, this mood was picked up after the 2010 election by the new coalition government, so that in June 2010, the Treasury announced that the FSA will be divided and its activities assumed by the two new authorities:

a) The Prudential Regulation Authority (PRA),[173] is an operationally independent subsidiary of the Bank of England (the Bank), responsible for the micro-prudential regulation of banks, insurers and other prudentially significant firms.
b) The Financial Conduct Authority (FCA),[174] the current FSA legal entity renamed, is responsible for regulating conduct in retail, as well as wholesale financial markets, and the infrastructure that supports those markets. The FCA has responsibility for the prudential regulation of firms that do not fall under the PRA's scope.
C) The government has also established the Financial Policy Committee (FPC)[175] which will be a committee of the Bank of England. The FCP's responsibilities are to deliver systemic financial stability.

[172] The Libor scandal in 2012 was a series of fraudulent actions connected to the Libor (London Interbank Offered Rate) and also the resulting investigation and reaction. The Libor is an average interest rate calculated through submissions of interest rates by major banks in London. The scandal arose when it was discovered that banks were falsely inflating or deflating their rates so as to profit from trades, or to give the impression that they were more creditworthy than they were. For more details see Konchar, S. G. (2014) The 2012 LIBOR scandal: an analysis of the lack of institutional oversight and incentives to deter manipulation of the world's most "important number". *Transnational Law & Contemporary Problems*. Volume 23. Issue 1; and Vasudev, P. M. & Rodriguez, G. D. (2014) Corporate governance in banks - A view through the LIBOR lens. *Journal of Banking Regulation*. 15(3-4). 325-336.
[173] Bankofengland.co.uk (2014) *Prudential Regulation Authority*. [Online] available from: http://www.bankofengland.co.uk. [Accessed: 2 April 2014].
[174] Fca.org.uk (2014) *Financial Conduct Authority "FCA."* Available from: http://www.fca.org.uk. [Accessed: 2 April 2014].
[175] Bankofengland.co.uk (2014) *Financial Policy Committee*. [Online] available from: http://www.bankofengland.co.uk. [Accessed: 2 April 2014].

This clear shift from an integrated regulatory regime to a "Twin Peaks" approach, similar to that practiced in the Netherlands and Australia, is a direct result of the difficulties faced by the UK financial markets as a result of the financial crisis. The UK's integrated "tripartite" regulatory approach, namely; the BOE, the FSA and the Treasury were collectively responsible for the financial stability of the UK capital markets and this system apparently failed to effectively identify the issues that were building in the financial system as well as to take steps to mitigate these issues.[176]

These failures occurred because the tripartite system vis-à-vis the "Twin Peaks" approach places responsibility for all financial regulation in the hands of a single financial regulator, in this case the FSA. The FSA was not able to effectively deal with all matters ranging from safety of the largest investment banks to the customer practices of the small financial advisers.[177] Similarly, the BOE did not have the tools or levers to carry out its role effectively as primary provider of financial stability, whilst the UK Treasury has overall responsibility for maintaining the legal and institutional framework but empowered with no clear responsibility for dealing with a crisis which placed billions of pounds of public funds at huge risk.[178]

The shift to Twin Peaks therefore necessitated a strong focus on two key areas, prudential regulation and conduct-of-business/consumer protection and markets regulation. There is now a dedicated focus on macro-prudential oversight to ensure that any future risks developing across the financial system are quickly identified and responded to. That is why the UK Government has established the FPC whose role is to maintain financial stability. Twin Peaks allows the macro-prudential regulation of the financial system to be coordinated with the prudential regulation of individual firms. It is for this reason the UK Government transferred operational responsibility for prudential regulation from the FSA (now the FCA) to a new subsidiary of the Bank of England called the PRA which is responsible for all prudential regulation of all deposit-taking institutions, insurers and investment banks in the

[176] In many instances, references to regulatory deficiencies or weaknesses conflate a number of issues that should be considered separately if the diagnosis of causal influences is to make a meaningful contribution to regulatory reform. A distinction between the significance of the institutional structure of regulation on the one hand and the operation of the substantive rules on the other is generally recognised but further important distinctions need to be drawn within the substantive rules. See House of Commons Treasury Committee. (2008) The run on the rock. In: *Fifth Report of Session 2007–08*. Volume II, London: HMSO, HC56-II. Ev253. See also MacNeil, I. (2010) The Trajectory of Regulatory Reform in the UK in the Wake of the Financial Crisis. *European Business Organization Law Review*. Volume 11(4). 8, 9.

[177] Fsa.gov.uk (2009) *Turner Review: a regulatory response to the global banking crisis*. [Online] available from: http://www.fsa.gov.uk/Pages/Library/Corporate/turner/index.shtml. [Accessed: 25 June 2013]. The review was commissioned by the Chancellor of the Exchequer in October 2008 in terms that requested the Chairman of the FSA (Lord Turner) to review the causes of the crisis and make recommendations for change in regulation and supervision of banks. On the other hand, see Fsa.gov.uk (2009) *Turner Review Conference Discussion Paper*. October 2009. [Online] available from: http://www.fsa.gov.uk/pubs/discussion/dp 09_02.pdf. [Accessed: 2 September 2013]. See also Walker, G. (2010) The Global Credit Crises and Regulatory Reform. In: MacNeil and O'Brien (eds.). *The Future of Financial Regulation*. United Kingdom: Hart Publishing. 161-178. In: MacNeil and O'Brien (eds.). *The Future of Financial Regulation*. United Kingdom: Hart Publishing. 179-203.

[178] Blei, S. K. (2008) The British Tripartite Financial Supervision System in the Face of the Northern Rock Run. *Federal Reserve Bank of St. Louise Supervisory Policy Analysis Working Papers*. 1. [Online] available from: https://ideas.repec.org/p/fip/fedlsp/2008-01.html. [Accessed: 29 June 2013].

UK. The utility of the Twin Peaks system is evident in that by placing firm specific prudential regulation under the BOE, the government has brought together responsibility for both micro and macro prudential regulation under one roof. This means that regulatory powers will be certain and there will be no gaps in the system.

Meanwhile, regulation of conduct of business within the financial system which includes the conduct of firms to their retail customers falls under the remit of the FCA which, as stated earlier plays a vital role in enhancing consumer confidence in the UK's financial systems whilst simultaneously securing consumer protection. The FCA is empowered to regulate conduct-of-business for all financial firms including prudentially significant firms, deposit takers, insurance, investment firms and other financial providers.

The advantages of the Twin Peaks approach is really based upon the principle of regulation by objective and deals with the separation of regulatory functions between two regulators; namely the PRA and the FCA. One regulator performs the safety and financial stability supervision function whilst the other focuses on conduct-of-business. The Twin Peaks Approach may also be the best means of ensuring that issues of transparency, market integrity, and consumer protection receive sufficient priority. The approach is designed to ensure that sales practice protections apply uniformly across all financial products, regardless of the legal status of the entity selling the product.[179]

### 3.2.2. The Scope and Breadth of the 2012 Act.

The 2012 Act, which came into force on 1 April 2013, contains the UK government's reforms of the UK financial services regulatory structure and creates a new regulatory framework for the supervision and management of the UK's banking and financial services industry. The Act gives the Bank of England macro-prudential responsibility for oversight of the financial system and day-to-day prudential supervision of financial services firms managing significant balance-sheet risk. Three new bodies have been formed under the Act: the FPC, the PRA and the FCA. While the Act mainly contains the core provisions for the UK government's structural reforms and will therefore make extensive changes to Financial Services and Markets Act 2000 (FSMA), as well as to the Bank of England Act 1998 and the Banking Act 2009, it also includes freestanding provisions in Part 3 ('mutual societies'), Part 4 ('collaboration between Treasury and Bank of England, FCA or PRA'), Part 5 ('inquiries and investigations'), Part 6 ('investigation of complaints against regulators') and Part 7 ('offences relating to financial services').

The strategic objective differs from the original proposed objective in the draft Financial Services Bill (the "Bill"), which was expressed as being the protection and

[179] Group of Thirty (2008) *The structure of Financial Supervision Approaches and Challenges in a Global Marketplace*. Washington, DC. 38. [Online] available from: http://www.group30.org/images/PDF/The%20 Structure%20of%20Financial%20Supervision.pdf. [Accessed: 15 June 2013].

enhancement of confidence in the UK financial system.[180] The "relevant markets" are defined as:

- The financial markets (although this term itself is not defined in the 2012 Act);
- Markets for regulated financial services (as defined in a new Section 1(H)(2) of FSMA); and
- The markets for services that are provided by unauthorised persons in carrying on regulated activities without contravening the general prohibition.

The FCA has three operational objectives:

- To secure an appropriate degree of protection for consumers (the consumer protection objective) (new Section 1C, FSMA);
- To protect and enhance the integrity of the UK financial system (the integrity objective) (new Section 1D, FSMA); and
- To promote effective competition in the interests of consumers in the markets for regulated financial services and services provided by recognised investment exchanges in carrying on certain regulated activities (the competition objective) (new Section 1E, FSMA).

Matters to which the FCA must have regard when considering the consumer protection objective include factors such as the differing expectations that consumers may have in relation to different kinds of investment or other transactions. The competition objective replaces the third objective set out in the Bill, which was the promotion of efficiency and choice in the market for certain types of services (referred to then as the "efficiency and choice objective"). Following a recommendation in the Independent Commission on Banking's final report,[181] the UK Government decided to recast the efficiency and choice objective in terms of promoting effective competition in the interests of consumers.

Separate from the competition objective, the FCA is also be obliged to discharge its general functions in a way that promotes competition in the interests of consumers (new Section 1B(4), FSMA). While this general obligation was included in the Bill, the final provision in the Act includes additional wording requiring the promotion of competition in "the interests of the consumer."[182] The scope of the FCA's activities includes:

[180] For more details about the draft Financial Services Bill (the "Bill") and the subsequent changes, see UK Parliament (2013) *Draft Financial Services Bill*. [Online] available from: http://www.parliament.uk/business/committees/committees-a-z/joint-select/draft-financial-services-bill/. [Accessed: 19 June 2013].

[181] *Ibid*.

[182] Independent Commission on Banking (2011) *Final Report Recommendations*. [Online] available from: http://webarchive.nationalarchives.gov.uk/20131003105424/https:/hmtsanctions.s3.amazonaws.com/ICB%20final%20report/ICB%2520Final%2520Report%5B1%5D.pdf. [Accessed: 4 January 2015].

- Conduct of business regulation for all firms in both retail and wholesale markets. The FCA will be responsible for the conduct of business regulation of all regulated firms, including PRA-authorised firms and firms "passporting" their way into the UK.
- Acting as the lead regulator for those firms currently regulated by the FSA other than PRA-authorised firms, including in respect of prudential supervision. The Act refers to these firms as FCA-authorised firms.
- The FCA has inherited the former FSA's existing roles relating to markets regulation under Part XVIII of FSMA, with the exception of the FSA's current responsibilities for settlement systems and recognised clearing houses ("RCHs"), which the FSA will transfer to the Bank of England. Institutions that provide both exchange services and central counterparty clearing services are regulated by the BOE with respect to their activities as RCHs and by the FCA as RIEs.
- The FCA has inherited the former FSA's responsibilities for the regulatory oversight of client assets and countering financial crime.
- The FCA has taken on most of the former FSA's market regulatory functions, including the FSA's acting as the UK Listing Authority ("UKLA").
- The FCA will also inherit the FSA's existing responsibilities for certain institutions operating outside the FSMA regulatory perimeter, including:
  - E-money firms;
  - Payment service providers; and
  - Mutual societies.

In its October, 2012 paper entitled "Journey to the FCA,"[183] the FSA stated that the FCA will be the conduct supervisor for approximately 26,000 firms across all industry sectors and the prudential supervisor for approximately 23,000 firms not regulated by the PRA. Following the September 2012 Wheatley Report[184] into the regulation of the London

[183] See Fca.org.uk (2012) *Journey to the FCA - Financial Conduct Authority*. October 2012. [Online] available from: https://www.fca.org.uk/static/documents/fsa-journey-to-the-fca.pdf.; Fca.org.uk (2013) *Legal Cutover (Variation of Permission) Instrument*. 2013. [Online] available from: http://media.fshandbook.info/Legislation/2013/FCA_2013_12_PRA_2013_7.pdf.; and Fca.org.uk (2014) *The FCA Approach to Supervision for C3 firms.* March 2014. [Online] available from: https://www.fca.org.uk/static/documents/corporate/approach-to-supervision-c3-guide.pdf. [Accessed: 2 October 2014]. See also Gibson, D. & Crutcher (2012) *Memorandum Financial Services Act 2012: A New UK Financial Regulatory Framework - All Change?*. [Online] available from: http://www.gibsondunn.com/publications/Documents/FinancialServicesAct-2012NewUKFinancialRegulatoryFramework.pdf. [Accessed: 4 March 2013]. Further, see the statement by the Financial Secretary to the Treasury, Mark Hopan MP, on financial regulation delivered and published on 17 June 2010, available from: HM Treasury (2012) *Statement to the House of Commons by the Financial Secretary to the Treasury on reforming the institutional framework for financial regulation*. [Online] available from: http://www.hm-treasury.gov.uk/statement_fst_170610.htm. [Accessed: 14 May 2013]; and Mofo.com (2010) A Step Forward or Backward? FSA to be Broken Up. *Morrison & Foerster News Bulletin.* [Online] available from: http://media.mofo.com/files/Uploads/Images/100621FSA_to_be_ Broken_Up.pdf. [Accessed: 14 May 2013].

[184] Wheatley, M. (2012a) The Wheatley Review of LIBOR: Initial Discussion Paper (August). *HM Treasury*. London. [Online] available from: www.gov.uk/government/uploads/system/uploads/attachment_data/file/191763/condoc_wheatley_review.pdf.; and Wheatley, M. (2012b) The Wheatley Review of LIBOR: Final Report

Inter-Bank Offered Rate (LIBOR), the government decided to amend the Bill to bring certain activities relating to the setting of benchmarks within the regulatory scope of FSMA, and these are set out in Section 7 of the Act. The HM Treasury intends to amend the FSMA (Regulated Activities) Order 2001 (SI 2001/544) ("RAO") to create two new activities: "providing information in relation to a regulated benchmark," and "administering a regulated benchmark."[185]

The FCA is not responsible for:[186]

- Preventing all conduct or prudential failure;
- Handling individual complaints on financial services (this will remain the responsibility of the Financial Ombudsman Service (FOS);
- Acting as an economic or price regulator, such as the Office of Communications (Ofcom) or other utility regulators in the sense of prescribing returns for financial products or services; however, in performing its new competition role, it will be interested in prices because prices and margins are key indicators of whether a market is competitive;
- Intervening in areas where it does not have a statutory responsibility; the FCA does not intend to provide kite-marking or product approval for financial services products, although it will have additional product intervention powers; or
- Setting social policy, which will be a matter for the government, rather than the FCA.

### 3.2.3 Other Amendments to FSMA by the 2012 Act.

In addition to the foregoing major regulatory overhauls, other key amendments to the FSMA brought about under the 2012 Act include each of the following:[187]

- As well as integrating the UKLA into the new FCA, applying the general FCA objectives to the listing regime;
- Extending the powers of the FCA to impose sanctions on sponsors for breaches of UKLA rules and requirements imposed on sponsors (Section 18 of the Act). This will include the ability to impose financial penalties and to suspend a person's approval as a sponsor or restrict their activities; such sanctions will be subject to the normal enforcement and appeal mechanisms in FSMA;
- Extending the limitation period for taking action for breaches of Part 6 of FSMA (relating to listings) from two to three years (Section 20 of the Act);

(September). *HM Treasury*. London. [Online] available from: http://cdn.hm-treasury.gov.uk/wheatley_review_libor _finalreport_280912.pdf. [Accessed: 16 May 2013].

[185] Gov.uk (2013) *The Government responses to the Parliamentary Commission on Banking Standards*. July 2013. [Online] available from: https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/191762/wheatley_review_libor_finalreport_280912.pdf. [Accessed: 16 October 2013].

[186] See Gibson & Crutcher (2012) *'Memorandum Financial Services Act 2012…', supra* note 183.

[187] *Ibid.*, 4-5.

- Giving the FCA power to regulate primary information providers (PIPs) (organisations which channel information from issuers to the UKLA and announce information to the market) (Section 19 of the Act); the Act amends the FSMA to give the UKLA powers in relation to PIPs' continuing obligations, their supervision and to impose sanctions on them;
- Giving the FCA power to direct a firm to withdraw a financial promotion that the FCA considers is likely to breach its rules concerning financial promotion, subject to certain safeguards;
- Allowing the FCA to discontinue or suspend a listing at the request of an issuer without following the warning notice and decision notice procedure (Section 17); the UK government regards the warning notice and decision notice requirements as onerous and unnecessary when the FCA is agreeing to an issuer's request; and
- Giving the FCA power to disclose the fact that a warning notice has been issued in relation to proposed disciplinary action against a firm or individual.

The UK Government believes that credible and effective enforcement action should remain a key focus for the FCA. It therefore expects the FCA to continue the former FSA's existing credible deterrence policy. The UK government's view is that the existing arrangements in FSMA relating to enforcement action have worked well to date, and accordingly the Act does not make significant amendments to those arrangements (other than the change relating to the publication of information about warning notices). In its October, 2012 paper, "Journey to the FCA," [188] the FSA confirmed that the FCA would retain the FSA's existing Regulatory Decisions Committee (RDC), which makes decisions on contested enforcement and certain supervisory and authorisation matters on behalf of the FSA. The FCA will retain the FSA's current allocation of decision making between the RDC and senior executive, and any decision to change the current procedures will be a matter for the future FCA Board following a public consultation.

In her speech, Tracey McDermott, the director of the FSA's Enforcement and Financial Crime Division, emphasised that the FCA will continue the FSA's policy of credible deterrence and also stated that the approach of the FCA's enforcement division would include the following:[189]

- Focusing increasingly on those in senior management that fail to recognise and manage their firms' risks, that fail to control the way that products are sold and that fail to ensure that consumers' interests are prioritised when designing financial products.
- Working in a more integrated way with supervisors and other FCA colleagues on thematic and firm-specific work.

[188] Fca.org.uk (2012) *'Journey to the FCA…', supra* note 183.
[189] See the FCA *'Legal Cutover (Variation of Permission)…', supra* note 183, at 38, 59.

- Using existing tools such as own initiative variations of permission ("OIVoPs") [190] more readily as well as new tools, such as product intervention powers.
- Having a low tolerance for repeat offenders. The FCA will be more ready to take action against firms that fix immediate problems but do not think about the underlying causes.[191]

The Act also contains a series of miscellaneous legislative changes, including provision that will enable the UK government to transfer consumer credit regulation to the FCA.[192] The 2012 Act went into formal force and effect on 1 April 2013. It will be implemented through a panoply of enabling secondary legislation, a process that is now on-going and which will undoubtedly continue to remain on-going for quite some time.

### 3.3 Conclusion

Up until the promulgation of the 2012 Act, securities regulation within the UK had been relatively stable in terms of the established statutory scheme, regulations, and rules. Things had been that way for about a dozen years, since the adoption of FSMA back in 2000. But the global events over the past five years on many fronts – but particularly political and economic – have shaken up many institutions. Among the casualties of this sea-change in the way the world works has been the UK's once-entrenched system for the regulation of all-things-securities, from securities markets, to securities underwriters, to securities dealers, to virtually all other market participants. It cannot yet be said with certainty to what exact extent regulation in each of these areas will change over the coming months and years: The pivotal 2012 Act, that has unveil itself in terms of the many interpretations and applications to which it will eventually become subject.

Having laid the foundation of the securities and market as the benchmark of this thesis; the next two chapters will draw similar discussion of the relevant laws in both the KSA and the UAE. The capital market act, the securities and issuers regulations, market conduct and corporate governance rules will be used for the KSA case.

[190] If a firm that we authorise wants to change or add to its regulated activities it can apply to the FCA for a 'variation of permission'. See Fca.org.uk (2014) *Welcome to FCA Firms- Variation of permission*. [Online] available at: https://www.the-fca.org.uk/variation-permission-vop. [Accessed: 2February 2014].
[191] The FCA *'Legal Cutover (Variation of Permission)…'*, *supra* note 183, at 38, 59
[192] The Financial Services Act 2012 (Part 9), *supra* note 170.

## Chapter Four

## The Regulatory Environment within the Kingdom of Saudi Arabia

This Chapter elaborates on the evolution of the institutional structure responsible for the regulation of securities markets in KSA as well as highlights the key aspects of its listing, disclosure, market conduct and corporate governance rules.

### 4.1 Structure of Securities Markets in KSA

#### 4.1.1 Saudi Arabian Monetary Authority (SAMA)[193]

SAMA is the Central Bank of the KSA and was established in 1952. It has been entrusted with performing many functions pursuant to several laws and regulations. The most important functions include: dealing with the banking affairs of the Government; minting and printing the national currency (the Saudi Riyal); managing the Kingdom's foreign exchange reserves; managing the monetary policy for maintaining the stability of prices and exchange rate; promoting the growth of the financial system and ensuring its soundness; supervising commercial banks and exchange dealers; supervising cooperative insurance companies and the self-employment professions relating to the insurance activity and finally supervising finance companies. Insurance and pensions also fall under the remit of SAMA. The 2003 Law and 2004 Implementing Regulations provide broad powers and SAMA has established an effective supervisory function. Five important functional regulations (including risk management, reinsurance, and market conduct) have been issued since 2008.[194]

Since SAMA is the legislative body responsible for exercising regulatory and supervisory control over banks and money exchangers, issuing general rules and overseeing that all banks and money exchangers comply with and effectively implement the rules and regulations of KSA,[195] it regards the adoption and implementation by all banks and money exchangers of effective policies, procedures and controls for the deterrence and prevention of money laundering, terrorist financing and other financial crimes as very vital. SAMA expects all banks and money exchangers and their employees to conduct business in accordance with these rules and all applicable laws by applying the highest ethical standards.

SAMA has a duty not only to ensure banks and money exchangers maintain high KYC standards to protect their own safety and soundness but also to protect the integrity of their national banking system. SAMA duties include monitoring that banks and money exchangers are applying sound KYC procedures and are sustaining ethical and professional

[193] Sama.gov.sa (2014) *Homepage.* [Online] available from: http://www.sama.gov.sa/en-us/pages/default.aspx. [Accessed: 20 August 2014].
[194] See Imf.org (2012) *Saudi Arabia: Financial System Stability Assessment—Update*. IMF Country Report No. 12/92.April 2012. [Online] available from: https://www.imf.org/external/pubs/ft/scr/2012/cr1292.pdf. [Accessed: 7 June 2014].
[195] See Sama.gov.sa (2013) *SAMA Functions*. [Online] available from: http://www.sama.gov.sa/sites/samaen/AboutSAMA/Pages/SAMAFunction.aspx. [Accessed: 15 March 2013].

standards on a continuous basis and ensuring that appropriate internal controls are in place and banks and money exchangers are in compliance with supervisory and regulatory requirements. SAMA examination will include review of banks and money exchanger's policies and procedures, customer files including sampling of some accounts, documentation related to accounts maintained and the analysis made to detect unusual or suspicious transactions including taking appropriate action against banks or money exchangers and their officers and employees who demonstrably fail to follow the required procedures and regulatory requirements.[196]

### 4.1.2 The Capital Market Authority (CMA)[197]

KSA Capital Market has been in operation for many years with substantial trading since 1970 and is considered to be the largest in the GCC and certainly the deepest in terms of liquidity and volume.[198] It was regulated by a ministerial committee comprising Ministry of Finance (MOF), Ministry of Commerce and Industry (MOCI), and the Saudi Arabian Monetary Authority (SAMA) but this changed when the Capital Market Law (CML) came into effect on February 25, 2004 and the CMA was established.[199] The establishment of the CMA has contributed to the immense growth of KSA equity capital markets over the last decade. Some of the largest listed companies in the Middle East are on the Saudi Tadawul,[200] and account substantially towards overall market capitalisation including SABIC, a globally recognised multinational company.[201]

The CMA is the only entity responsible for administering the primary securities law of KSA. The CMA was given rule-making authority and enforcement powers necessary to fulfill its objectives (the protection of investors, reduction of systemic risk, and the fairness, efficiency, and transparency of the capital market). The CMA's regulatory responsibilities are broad and include offers and issuance of securities, listing, trading and settlement on Tadawul, disclosure by issuers and governance, licensing, supervision and enforcement of its regulations, credit rating agencies, as well as the establishment, offering and management of funds including any OTC activity. The CMA also possesses both civil and criminal authority and may seek civil sanctions ranging from warnings to monetary penalties, property seizure, and license suspension or revocation.

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[196] See Sama.gov.sa (2013) *Rules Governing Anti-Money Laundering & Combating & Combating Terrorist Financing For all banks and money exchangers and foreign banks' branches operating in the Kingdom of Saudi Arabia*. Third Update February 2012. [Online] available from: http://www.sama.gov.sa/arsa/Laws/Banking Rules/B%20and%20E%20AML%20CTF%20Rules%20Final%203rd%20Update.pdf. [Accessed: 4 February 2014].

[197] Cma.org.sa (2012) *Homepage.* [Online] available from: http://cma.org.sa/en/Pages/ home.aspx. [Accessed: 3 May 2013].

[198] The Saudi Stock Exchange is the largest exchange in the Middle East in terms of the number of IPOs, by market capitalisation and by capital raised, *supra* notes 56 & 57.

[199] KSA Capital Market Law (CML), issued by Royal Decree No. (M/30) of 2003, *supra* note 2.

[200] See Tadawul, *supra* note 53.

[201] SABIC is one of the world's largest petrochemical producers and has offices and branches all over the globe. It specialises in the manufacturing of chemical, plastics, fertilizers and metals, and the Saudi government owns 70% of its shares. See Sabic.com (2014) *About SABIC*. [Online] available from: http://www.sabic.com/ corporate/en/. [Accessed: 2 February 2014].

Under CML, the CMA has also general and broad powers for inspection and investigation and conducts full electronic surveillance of the market. An inspection program adopting a cycle of two to three years (risk and compliance-based) is conducted via on-site inspections and review of compliance with specific regulations and/or submits false or misleading information in any document filed with the CMA. In some cases, the period of this cycle may extend to four or five years depending on the situation and the reputation of the company in the market.

There are also general sanctions stipulated in the regulations which can be applied to any person who engages in or is about to engage in acts or practices that constitute a violation of the CML or its Implementing Rules and Regulations.[202] The range of such sanctions includes bringing enforcement action seeking civil and criminal penalties and right to indemnity; issuing a warning to the concerned person or issuing a cease and/or desist order; requiring the person to take necessary steps to avert the violation; requiring the violator to pay to the CMA the gains realised as a consequence of the violation; suspending the trading in the security; barring the violator from acting as a broker, portfolio manager or investment adviser; issuing a travel ban and CMA has finally disciplinary action, revocation or suspension of licensing in the most extreme cases. The final word on a pending case relating to violations rests with the CMA and appeals committee supervised by it.

The CML also establishes standards of conduct designed to ensure the integrity and professionalism of the staff. Its employees are prohibited from engaging in any other job or profession and from providing advice to any company or private institution. On accepting employment, the CMA staff must disclose their securities holdings and the securities holdings of their relatives. Trading on Tadawul is strictly prohibited unless prior written confirmation and approval is given by the Authority. Any execution of trades must be conducted within a specified timeframe and duration. The CMA also has adopted rules of professional conduct which incorporates relevant provisions of the CML and establishes additional prohibitions and requirements designed to avoid conflicts of interest, protect confidentiality and personal information and assure the appropriate use of information.[203]

The CML defines the duties and powers of the CMA, Tadawul and the Securities Depositary Center. It also initiated special committees to deal with breaches of provisions and rules of its law. These committees are the Committee for the Resolution of Securities Disputes (CRSD), a special body with jurisdiction over all claims and matters falling under the CML and its rules and regulations, and the Appeal Committee for the Resolution of Securities Conflicts (ACRSC), which is the higher and appellate authority that has the final review of the decisions issued by the CRSD.[204]

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[202] See Cma.org.sa (2013) *Implementing Regulations*. [Online] available from: http://cma.org.sa/En/Pages/Implementing_Regulations.aspx. [Accessed: 11 May 2013].
[203] Article 19 of the Capital Market Law No. (M/30) of 2003, *supra* note 2.
[204] For more details about the two committees, see Chapter Six, *infra*.

The CMA is accountable to the President of the Council of Ministers and has by virtue of the CML[205] access to a number of sources of funds, including fees, financial penalties, and funds provided by the government. Audited financial accounts of the CMA can be accessed from its website,[206] however, those of Tadawul (wholly owned by the government via an investment company) are not published and therefore its financial details are hard to access. Clearly, the CMA is well funded, staffed and equipped and has markedly improved and invested in its technology infrastructure including state of the art market tracking surveillance software

The CMA rules and regulations have broadly reflected the changing market needs both from financial and from a regulatory perspective. The regulation of banks and insurers is the responsibility of SAMA except to the extent they have obligations as listed companies in respect of which they fall within the jurisdiction of the CML and therefore the CMA. There is historically a grey area of conflict between the two regulators which has contributed to a degree of confusion in the markets over the years especially with regards to the issuance of rules and regulations which sometimes appear to be in conflict with each other. However, SAMA plays a large and indeed powerful role in the regulation of the financial laws of the Kingdom.[207]

### 4.1.3 The Stock Exchange (Tadawul)[208]

The objectives of the Saudi Tadawul are ensuring fair, efficient and transparent listing requirements, trading rules and technical mechanisms and information for securities listed on the Exchange as well as providing sound and rapid settlement and clearance rules and procedures through its Securities Depositary Center. Tadawul is also responsible for establishing and enforcing professional standards for brokers and their agents and ensuring the financial strength and soundness of brokers through the periodic review of their compliance with capital adequacy requirements, and setting such arrangements to protect the funds and securities in the custody of brokerage companies.

The Exchange is managed by a board of directors comprising nine members who are appointed by a Council of Ministers resolution upon nomination by the chairman of the Board of the Authority and who will choose from among them a chairman and a vice chairman. The membership of the board is to be composed of a representative of the Ministry of Finance, a representative of the Ministry of Commerce and Industry, a representative of the Saudi Arabian Monetary Agency, four members representing licensed brokerage companies and two members representing the joint stock companies listed on the Exchange.

There are no SROs as Tadawul does not exercise regulatory powers although it is responsible for operationally running the market and the Depository.Tadawul operates the

[205] Article 13 of the Capital Market Law No. (M/30) of 2003, *supra* note 2.
[206] Cma.org.sa (2013) *Annual Reports*. [Online] available from: www.cma.org.sa/En/Publicationsreports/Pages/AnnualReport.aspx. [Accessed: 3 May 2013].
[207] See Sama.gov.sa (2013), *supra* note 193.
[208] See Tadawul, *supra* note 53.

only licensed market in KSA established as a joint stock company under the Companies Regulations,[209] but regulated by the CMA as per the provisions of the CML. It conducts trading in equity securities and debt instruments (including sukuk) of listed companies, corporate bonds and Exchange Traded Funds (ETF's).[210]

Trading occurs on a time price priority basis via a central order book with one session per day. Mutual funds release information publicly via Tadawul, but the funds are not traded on market.[211] Direct foreign participation in equities is only permitted via swaps entered into with Saudi members of Tadawul although direct foreign participation is permitted in funds and ETFs.[212] A major drawback has been the lack of regulation permitting direct trading by foreigners which is an issue that is currently being addressed.[213]

### 4.1.4. The Securities Depository Centre [214]

The board of directors of the Exchange have established a department to be known as the "Securities Depositary Center" which is be the sole entity in the Kingdom authorised to practice the operations of deposit, transfer, settlement, clearing and registering ownership of KSA securities traded on the exchange. The registration of ownership of Securities traded on the Exchange and the settlement and clearance of Securities are made by entries in the Depositary Center's records. Ownership of securities traded on the Exchange must be registered with the Depositary Center in order to be protected against third party claims.

[209] The Saudi Arabia Company Regulations Royal Decree No. M/6 of 1385 Hijri.

[210] ETFs are investment funds divided into equal units traded on the exchange during trading time, similar to stocks. ETFs enjoy advantages of both mutual funds and stocks. Like other investment funds ETFs are composed of a basket of assets (listed companies shares), however unlike mutual funds ETFs are traded on the exchange. ETFs are characterised by the existence of the market maker who is working to simulate the performance of its indices by continuously placing bids & asks in the ETF market. See Tadawul.com.sa (2013) *Exchange Traded Funds*. [Online] available from: http://www.tadawul.com.sa/wps/portal/!ut/p/c0/04_SB8K8x LLM9MSSzPy8xBz9CP0os3gX35DgIB9TQwN_CycLA89gS3cvby9LYwNfc_3g1Dz9gmxHRQCj8xdI/. [Accessed 25 December 2013].

[211] Development and growth have encompassed all areas of the Saudi economy, including investment funds, which have recorded a great expansion in the value of their investments and in the number of their subscribers (which grew by an annual rate of 20 per cent during the period from 1992 to the end of 2003). The number of funds floated rose from 52 to 151, and the value of their total investment assets increased from SAR 12.4 billion to SAR 52.23 billion (approximately US$13.928 billion) over the same period. For that, stock market growth, in the Saudi Arabian market, was fostered by significant growth in the Saudi mutual fund segment, which rose to a peak of SAR 137 billion (US$36.5 billion) in 2005. See Al-Jarf, M. (2004) The Impact of Globalization on Saudi Capital Market. In *The International Conference of Islamic Scholars*. Jakarta, 23rd to 26th February 2004; and Ramady, M. A. (2010) *The Saudi Arabian Economy: Policies, Achievements and Challenges*. 2nd Ed. United States: Springer.

[212] The CMA issued Circular No. 2-28-2008 on 18 August 2008 (08/17/1429) allowing foreign investors to execute, under certain terms and conditions, equity swap agreements in respect of listed Saudi Shares. The circular permits only CMA Authorised Persons to enter into Swap Agreements. See for example, Morganstanley.com (2008) *Morgan Stanley Saudi Arabia Executed First Equity Swap Agreement in the Kingdom, Press Release*. 25 August 2008. [Online] available from: http://www.morganstanley.com/about/press/ articles/6849.html.[Accessed: 21 August 2014].

[213] Cma.org.sa (2014) *Draft Rules for Qualifies Foreign Financial Institutions Investment in Listed Shares*. [Online] available from: http://cma.org.sa/en/Documents/Draft%20Rules%20for%20Qualified%20Foreign%20 Financial%20Institutions%20Investment%20In%20Listed%20Shares%20final%20pdf.pdf. [Accessed: 5 September 2014].

[214] See KSA Capital Market Law of 2003, Chapter Four (Articles 26-30), *supra* note 2.

Furthermore, the Center is the sole entity to register all property rights in securities traded on the Exchange.

## 4.2 Selective Regulations of Securities & Issuers

### 4.2.1 Offers of Securities Regulations [215]

These regulations permit the issuing of securities as well as public invitation to subscribe to securities. Only a joint stock company in KSA may make an offer of securities. Offers of securities in KSA must comply with the Offers of Securities Regulations and the Listing Rules. The definition of "offer" is fairly broad, and includes the direct or indirect marketing of or any statement, announcement or communication that has the effect of selling, issuing or offering securities, but does not include preliminary negotiations or contracts entered into with or among underwriters.

Offers of securities are categorised as public offers or private placements. Public offers must comply with the Listing Rules. Similarly, securities offered by way of private placement must comply with the Offers of Securities Regulations and can be carried out by means of a limited offer to sophisticated investors. A limited offer is directed at no more than sixty offerees in KSA and the minimum amount to be paid by each offeree is not less than one million Saudi Riyals. An offer to sophisticated investors is directed at a number of potential investors including professional investors who fulfill at least two of the following criteria namely: having carried out at least ten transactions per quarter over the previous four quarters of a minimum total amount of forty million Saudi Riyals on securities markets, holds a securities portfolio whose value exceeds ten million Saudi Riyals or works or has worked for at least one year in the financial sector in a professional position.[216]

Offers of Securities must be fully underwritten and must comply with the CMA's Prudential Rules,[217] including any minimum capitalisation requirements they prescribe. An offeror must appoint a financial adviser when applying for the admission of securities to the official list, and the issue of securities which have not been previously admitted to the official list must be fully underwritten by an underwriter authorised by the CMA. The old Listing Rules required an underwriter to have a minimum net capital that was sufficient to meet any underwriting commitment. Alternatively, it could arrange financing or enter into sub-underwriting agreements to meet the underwriting commitment or meet such minimum net capital requirements respectively. This flexibility has now been removed and underwriters can no longer effectively transfer underwriting risk to a third party.

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[215] Cma.org.sa (2012) *Offers of Securities Regulations*. [Online] available from: http://www.cma.org.sa/En/Documents/OFFERS-OF-SECURITIES-REGULATION.pdf. [Accessed: 18 September 2012].
[216] *Ibid*.
[217] Section 62 of Prudential Rules. See Cma.org.sa (2013) *Prudential Rules*. 2013. [Online] available from: http://www.cma.org.sa/En/Documents/Final%20Draft%20Prudential%20Rules%20(English).pdf. [Accessed: 5 April 2013].

In line with practice in other developed markets, the Rules now provide investors with a withdrawal right or a right to amend their subscription application where they have subscribed for securities prior to the publication of a supplementary prospectus related to the offering. However, these rights may only be exercised by investors prior to the end of the offering period and there is no express guidance as to whether an offering period would be extended in such circumstances.

### 4.2.2 Listing Rules[218]

The CMA has issued Listing Rules that need to be complied with by all companies seeking to list on Tadawul. The rules provide the key requirements that an issuer needs to follow pre and post the listing process, after the issuer's board has approved the listing of the securities of the company.The CMA requires the issuer to appoint an independent financial adviser who is licensed by the CMA to advise the company on various CMA related rules and regulations. There are specific requirements that the financial adviser needs to fulfill with respect to the listing process. An independent legal adviser licensed to practice in KSA must also be appointed. Both must be independent and satisfies an independence test set out in Rules. The Rules also require the two advisers to provide each a letter addressed to the CMA which includes certain confirmations (including as to the issuer's compliance with the Rules and their own independence). Some of these confirmations are fairly broad in scope, such as the requirement for the financial adviser to confirm that the directors of the issuer have established adequate procedures, controls and systems to comply with CMA rules.[219]

These appointments not only ensure that investor rights are protected but also serve to improve transparency and market confidence. An applicant for admission and listing must be a Saudi joint stock company, and must have been carrying on as its main activity, either by itself or through one or more of its subsidiaries as an independent business for at least three financial years. The CMA has the discretion to accept an application if it is satisfied that such admission will be in the interests of the applicant and of the investors.

To be admitted to the official list,[220] an applicant for admission and listing must be a Saudi joint stock company, and must have been carrying on as its main activity, either by itself or through one or more of its subsidiaries as an independent business for at least three financial years. The Authority also has absolute discretion to reject an application in the event that the CMA considers the applicant as unsuitable for listing.[221] Furthermore, on an application for the admission of securities to the official list, the financial adviser must satisfy itself, having conducted due diligence, that the issuer has satisfied all conditions required for admission of its securities stipulated in the Listing Rules.

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[218] Cma.org.sa (2013) *Listing Rules*. [Online] available from: http://www.cma.org.sa/En/Documents/Listing%20 rules.pdf. [Accessed: 19 July 2013].
[219] *Ibid*., Articles 5, 8, 9 & Annexes 7, 8.
[220] *Ibid*., Article 13 (Conditions relating to registration and admission to listing of shares).
[221] *Ibid*.

Moreover, there must be a sufficiently liquid and open market for the shares to trade, as well there must be at least 200 public shareholders and at least 30% of the shares should be owned by the public. The CMA may permit a lower number of public shareholders or a lower percentage of the class of shares if it considers that it is appropriate in view of the number of shares in the same class and the distribution to the public. However, approval is required from the regulator in order to do this.Listing Rules set out the extensive requirements as to the prospectus which must be submitted for application for the issue of securities by way of a public offering.[222]

The CMA may suspend or cancel a listing if it considers it necessary for the protection of investors or the maintenance of an orderly market.[223] A listing may also be cancelled if an issuer fails, in a manner which the CMA considers material, to comply with the Listing Rules (including a failure to pay on time any fees or fines due to the CMA). Cancellation may also occur if there are insufficient securities of the issuer in the hands of the public to comply with the conditions or the CMA considers that the issuer does not have a sufficient level of operations or sufficient assets to warrant the continued trading of its securities on the Exchange.

There are specific restrictions on certain shareholdings.[224] A person or group shown in the prospectus to own a controlling interest in the issuer is not allowed to dispose of the securities of the issuer during the six months following the first date of trading. For the purposes of this provision a person or group owns a controlling interest in the issuer either where he owns, individually or together with his relatives or affiliates, directly or indirectly, a minimum of 5% of a class of voting shares of the issuer. Such restriction is in place to ensure market transparency.

Listed companies are required to comply with the listing rules and regulations on an on-going basis to ensure continuity of their status as a listed company.[225] Some of the key obligations include requirements relating to disclosure of material developments and financial information in accordance with the prescribed time lines, announcements, publications, duties of the board of directors, notification relating to securities, payments of fees, etc. All disclosures made by an issuer to the public and to the Authority must be clear, fair and not misleading. A lengthy description of the disclosure regime will follow.

In line with the CMA's current practice, applications for listing to the CMA must be accompanied by additional supporting documents, including a working capital report, financial and legal due diligence reports, a presentation on the corporate structure of the issuer's group and market studies detailing industry information and market trends mentioned in the prospectus. The Rules now also permit cross-listings of a foreign issuer's securities on Tadawul.[226]

[222] *Ibid*., Article 21 (The Prospectus).
[223] *Ibid*., Article 36 (Voluntary cancellation or suspension of listing).
[224] *Ibid*., Article 45, (Notification related to substantial holding in shares or convertible debt instruments).
[225] *Ibid*., Part 8.
[226] *Ibid*., Article 14 (Conditions Relating to Cross Listing).

### 4.2.3 Market Conduct Regulations[227]

Market conduct regulation as per the CMA relate to prohibitions of market manipulation, insider trading regulations and authorised persons' conduct. Market Conduct Regulations define the standard code of conduct for all participants to ensure the smooth functioning of the market and provide various rules to be followed by all market participants. Some of the provisions and contents of the market conduct regulations from a broader perspective are:

#### 4.2.3.1 Prohibition of Manipulation and Deceptive Acts[228]

Any person or organisation is prohibited from engaging in any activity relating to manipulation of the market or any acts of deception in connection with an order placed or transaction in a security. No person or company is allowed to directly or indirectly place an order or execute a transaction to give a false or misleading impression of trading activities or influence the market to create an artificial bid, price or trade price for any security. Any actions, including making a fictitious trade or affecting a trade in a security that involves no change in its beneficial ownership, will be considered as manipulative or deceptive. Entering an order(s) for the sale/purchase of a security with the prior knowledge that an order(s) of substantially the same size, time and price for the sale/purchase of that security, has or will be entered is prohibited.

#### 4.2.3.2 Insider Trading & Prohibition of Disclosure of Inside Information[229]

An insider is prohibited from disclosing any inside information to any other person when he knows or should have known possible that such other person may trade in the security related to the inside information. A person who is not insider is prohibited from disclosing to any other person any inside information obtained from an insider, when he knows or should have known that it is possible that such other person to whom the disclosure has been made may trade in the security related to the inside information.

#### 4.2.3.3 Record Keeping and Reporting of Manipulation[230]

An authorised person (AP) or a registered person must not accept or execute a client order if any of them has reasonable grounds to believe that the client is engaging in market manipulation or insider trading or if the client would be considered in breach of the law, regulations or rules applicable in the relevant market.

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[227] Cma.org.sa (2013) *Market Conduct Regulations*. [Online] available from: http://www.cma.org.sa/En/Documents/Market%20Conduct%20Regulation-26-8-009.pdf. [Accessed: 5 May 2013].
[228] *Ibid*., Article 2, Prohibition of Market Manipulation.
[229] *Ibid*., Part 3, Insider Trading.
[230] *Ibid*., Article 13, Conduct in case of market manipulation and insider trading by clients.

Of equal importance, where an AP or registered person has decided not to accept or execute an order which he suspects may be willful manipulation of the market then he is obliged by the rules to document the circumstances of and reasons for his decision in writing and the AP must notify the Authority of the decision within three days. An AP must retain the records in relation to any decision for ten years from the date of the decision.

### 4.2.4 Corporate Governance Regulations (CGRs) [231]

#### 4.2.4.1 The CMA Corporate Governance Framework

From a regulatory perspective the CMA regulation consists of three sets of rules. The first set focuses on the rights of shareholders, covering general rights, meeting, and distribution rights. The second wave of rules relates to disclosure and transparency which sets out policies and procedures for information disclosure and disclosure in board reports and financial statement reporting. The third set of rules covers guidelines specific to the board structure and responsibilities which focuses on setting out the basic functions of the board, its responsibilities and composition, and the role and responsibility of other committees such as the audit and remuneration committee.The followings are the disclosure requirements under the above CGRs:

#### 4.2.4.2 Obligation to Disclose Material Developments [232]

Transactions, events or announcements are considered to be a material development if any such activity is of a nature that would influence investment decisions by current or prospective stakeholders. Any changes in the composition of the board of directors or to CEO's position of the issuer are also considered material developments and must be immediately disclosed. Other material developments include legal proceedings involving value equal to or greater than 5% of net assets; related party transactions or any interruption in the principal activities of the issuer or its subsidiaries.

#### 4.2.4.3 Disclosure of Financial Information [233]

Keeping investors periodically updated with the financial performance and financial position of the company is critical from an investor's point of view. Therefore, it is mandatory for listed companies to provide certain information. Prior to publication the interim and annual financial statements of an issuer must be approved by the directors and signed by a director, CEO and CFO. Furthermore, the board of director's report must be filed with the Authority immediately upon approval by the directors. The issuer will announce to the exchange through the electronic applications its interim and annual financial statements

[231] Cma.org.sa (2013) *Corporate Governance Regulations*. [Online] available from: http://www.cma.org.sa/En/Documents/CORPORATE%20GOVERNANCE.pdf. [Accessed: 2 June 2013].
[232] *Ibid*., Article 10(f), Main Functions of the Board of Directors.
[233] *Ibid*., Article 9, Disclosure in the Board of Directors' Report.

prior to being published to the shareholders or third parties. Provision of interim financials to the CMA and announcement to public must not be later than 15 days after the end of the interim financial period.

#### 4.2.4.4 Disclosure Related to Securities [234]

The issuer of securities is required to disclose the following events without any delay to the CMA and the public including any change in persons holding more than 5% of the issued shares or convertible debt instruments of the company or of any significant changes in the holdings of such persons; any proposed change in the capital of the company as well as a decision to pay/declare or not to pay/declare dividend; alteration in rights to shareholders or debt holders as well as a decision to buy back securities along with the recommended price.

#### 4.2.4.5 Accounting standards [235]

Financial statements relating to listed companies disclosed in offering documents and on a continuing basis are subject to accounting and auditing standards established by the SOCPA,[236] a professional organisation that operates under the supervision of the MOCI. Audit reports of listed companies must be prepared by a certified independent accountant. Also, interim financial statements included in offering materials and the interim accounts of a listed company must be reviewed in accordance with standards established by the SOCPA.

### 4.2.5 CMA Prudential Rules [237]

The Prudential rules outline key financial requirements that AP's and firms must maintain. The rules also stipulate that an AP must continuously possess a capital base which corresponds to not less than the total of the minimum capital requirements. The capital base of an AP must comply with specific Tier-1 and Tier-2 capital requirements of the CMA Capital requirement regulations which are, of course, dependent on the size of the firm. All authorised trading firms must ensure sufficient capital to cover any eventualities including counterparty and settlement risks for trading book exposures; market risk for trading book operations (price movement volatility) and any foreign exchange (FX) risks. An AP or firm is required to develop and firmly implement a written policy that shows which financial instruments/commodities or portfolios of such financial instruments/commodities are to be assigned to the trading book and non-trading activities respectively.Furthermore, authorised

[234] *Ibid*., Article 8, Disclosure and Transparency.
[235] *Ibid*., Article 14, Audit Committee.
[236] Saudi Organisation of Chartered Public Accountants is a professional body based in Saudi Arabia that reviews and approves accounting and auditing standards in the Kingdom. SOCPA operates under the supervision of the Ministry of Commerce. See Socpa.org.sa (2013) *Saudi Organisation for Certified Public* Accountants. [Online] available from: http://www.socpa.org.sa/Home/Homepage. [Accessed: 3 August 2013].
[237] CMA Prudential Rules, *supra* note 217.

firms must have a written trading strategy for positions held as well as have clear procedures for the management of trading book positions and for monitoring risk-taking activities

## 4.3 Conclusion

This Chapter examined the development of the financial markets of KSA. SAMA, the CMA, Tadawul, and the Securities Depository Centre are developed institutions and function independently of each other with their respective roles. Their rights and obligations have been laid out in the respective laws with the CML being the overarching law dealing with formation and structuring of CMA itself. The CML also provides for the creation of an independent 2-tier structure for dispute resolution related to securities dealings. They are the Committee for the Resolution of Securities Disputes (CRSD), which has jurisdiction over the disputes related to securities under the CML and the Appeals Committee for the Resolution of Securities Conflicts (ACRSC), which is the higher and appellate authority. Regulations take care of financial reporting obligations of public companies as well as create the infrastructure for cross-border cooperation as. With its status of being the largest market, KSA financial market is well positioned to lead the markets of the region and take the leap to the next stage of development.

The following Chapter will draw paralleled discussion of the topics outlined in the goals and policies mentioned earlier, however due to the different approach by the regulator in the UAE, a different set of laws and regulations will be used to arrive at this end. A detailed examination of the securities markets regulations will serve this purpose along with an enhanced scrutiny of the disclosure related provisions and the proposed twin peaks initiative will develop the case study of the next Chapter.

## Chapter Five

## The Regulatory Environment Within the United Arab Emirates

This Chapter defines the financial market regulatory landscape prevalent in the UAE. It begins by briefly tracing the history of economic development of the UAE resulting in the beginning and development of the securities markets. Subsequent paragraphs layout the role of the different regulatory institutions in the UAE. Towards the end, selective securities regulations which deal with similar matters as those described for the UK and KSA earlier, are defined so that an appropriate comparative analysis can be performed in the Chapters to follow.

### 5.1 General background.

The UAE is a civil law jurisdiction and follows the civil law system, as such, the primary source of the law is a statutory code. The law in the UAE has also naturally been influenced by Islamic law codified in *Shari'a* and embodied in the UAE Civil and Commercial law. Once the UAE Federation was set up, the seven emirates [238] agreed on a provisional constitution (the Constitution) which provided the legal framework for the federation and apportioned powers between the federal government (based in Abu Dhabi) and the seven emirates. The Constitution came into effect in December 1971 and was permanently accepted in May 1996. It refers to the UAE as the 'Union.' The Constitution established the creation of the Supreme Federal Council, the Council of Ministers (as the Executive Branch of the federation), the National Assembly and the Judiciary of the Union.In addition to the Supreme Federal Council, the Federal Government includes the Council of Ministers. This Council is appointed by the President of the UAE and is responsible to the Supreme Council for the Union's general internal and external policy. There is also a Federal National Council which is responsible, under the Constitution, for examining proposed federal legislation.

The UAE's capital market is relatively young compared with regional and international peers. Historically, development of the UAE capital market had been slow, as most enterprises in the UAE were either government or family owned. The UAE has

[238] The United Arab Emirates is composed of seven Emirates which include: Abu Dhabi, Dubai, Sharjah, Fujairah, Ras Al Khaimah, Umm Al Quwain and Ajman. Abu Dhabi is the capital city. The three major emirates, in terms of participation in GDP, are Abu Dhabi, Dubai, and Sharjah. Abu Dhabi accounts for over 50% of the UAE's total GDP, some 40% of the population, and 95% of crude oil and gas production. Mainly resulting from the proceeds of its oil and gas industries, Abu Dhabi owns one of world's largest sovereign wealth funds. Dubai, the second largest emirate in terms of economic size, accounts for about a third of the UAE's total GDP. Dubai has a more diversified economy, with a large financial sector, as well as a developed air transport industry and tourism sector. Dubai also plays the role of regional commercial hub and is an important transshipment and re-export centre. For more information on the UAE economy and trade data, see Wto.org (2012) *Trade policy Review Report by United Arab Emirates.* WT/TPR/G/262. 21 February 2012. [Online] available from: http://www.wto.org/english/tratop_e/tpr_e/tp362 _e.htm. [Accessed: 26 July 2013]; and Imf.org (2013) *United Arab Emirates and the IMF*. [Online] available from: http://www.imf.org/external/ country/ARE/index.htm. [Accessed: 14 December 2013].

embraced some carefully calibrated structural and regulatory changes in the recent past, which have accelerated development and bolstered the future prospects of the country's capital market. The historical development of the UAE's capital markets can be examined into four broad phases which include the creation of the Central Bank of the UAE; the Ministry of Economy, the UAE Securities & Commodities Authority; and the Dubai Financial Services Authority.

The UAE's open door policy as well as foreign investment policies have contributed to the huge increase of direct foreign investment in the country in the past two decades. As an example, Jebel Ali Free Zone (Jafza) is one of the largest ports and container shipping terminals in the world. In its past years of operation, Jafza has posted more than 320 times growth in its number of companies growing from 19 in 1985 to over 6402 in 2009.[239]

The UAE has made significant strides in economic development over the last few years. This was primarily due to the UAE government's provision of an enabling regulatory environment. It is expected that services will play a larger role in the UAE economy over the medium to long run, with rapid increases in niche sectors such as air and maritime transportation, logistics, medical tourism, pharmaceuticals and information technology. The vision of the government of the UAE is to transform the country into a global hub for entrepreneurship in several industrial and service spheres. To achieve that vision, the Government is committed to maintaining *laissez faire* policies and an effective public-private partnership.

The nation is currently going through a huge expansionary period namely in construction and real estate. This has been an on-going economic activity for at least a decade and has brought in a large influx of foreigners to the country. With continued forecast expected as a direct result of such large commercial activities like EXPO as well as the Dubai Airshow, the UAE is a premier destination for large conglomerates, multinationals as well as major financial institutions.

The government continues to focus primarily on transforming the nation into a diversified self-sustaining market driven economy. Property laws have recently been reviewed as has the UAE Commercial Companies law. Foreign ownership regulations relating specifically to company ownership has impacted volume turnover on the stock exchanges. As a result of this, the role the financial regulator has had to play grows in prominence. Constant evolution of the economic landscape means the introduction of new rules and regulations by the financial regulator in order to keep up with and oversee the change. This increased volume has led to the introduction of several regulations especially in 2012 namely: liquidity providers and market making regulations, investment funds, short selling as well as securities lending and borrowing. For that, the Morgan Stanley Capital International Index (MSCI) ranking for the country was upgraded from that of a "Frontier

[239] *Ibids.* See also Economy.gov.ae (2011) *Investor's Guide to the UAE 2010-2011*. [Online] available from: http://www.economy.gov.ae/Investment_Guide_Arabic/INVESTOR%20GUIDE-%20AR-1.pdf. 6, 102. [Accessed: 12 December 2013].

market" to "Emerging." This achievement in itself is hugely important and is a key milestone in the history of the financial regulator.[240]

## 5.2 The Roles of the Primary Securities & Markets Regulators

### 5.2.1 The UAE Central Bank (CBUAE)[241]

The Central Bank of the UAE was established, under the name of the UAE Currency Board on 19 May 1973. Its objective was to issue a national currency that would replace the Bahraini Dinar and the Qatari and Dubai Riyal. The UAE dirham was put in circulation on 19 May 1973. A total of 12.9 million Dinars and 131 million Riyals were replaced by 260 million Dirhams in circulation.[242] On 10 December 1980, the Federal Law No. (10) of 1980 was issued concerning the Central Bank, the monetary system and organisation of banking,[243] through which the Currency Board was changed into the Central Bank of the UAE.

This Law empowered the CBUAE with far ranging powers which include organisation of the monetary, credit and banking policy as well as supervision of its implementation. The UAE government began the establishment of an industrially-based economy during the 1980's. However, the financing of these industrial projects required a new approach, which included the private sector. In view of the huge economic development that was happening in the UAE, the creation of the Central Bank of the UAE became necessary.[244]

The Law also authorised the CBUAE to issue currency as per the provisions of the law; ensure support for UAE dirham and its stability inside and outside the UAE as well as its free convertibility into foreign currencies. The CBUAE must also develop a credit policy that helps in achieving balanced growth of the UAE economy and also organise and develop banking as well as monitor the efficiency of the banking system, as per the provisions of the law.In addition. it licenses and regulates number of financial institutions such as local and foreign commercial and investment banks, financial investment companies, moneychangers, finance companies, monetary intermediation institutions (except brokerage firms) and

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240 Sca.gov.ae (2013) *UAE capital market upgraded to "Emerging Market" by MSCI*. [Online] available from: http://www.sca.gov.ae/English/news/Pages/12-06-2013.aspx. [Accessed: 12 August 2013].
241 Centralbank.ae (2013) *Homepage*. [Online] available from: http://www.centralbank.ae/en/index.php?option=com_content&view=article&id=147:organization-a-development&catid=43:aboutus&Itemid=109. [Accessed: 4 March 2013].
242 *Ibid*.
243 Centralbank.ae (2012) *Union Law No. (10) of 1980 Concerning the Central Bank, the Monetary System and Organization of Banking*. August 1980. [Online] available from: http://www.centralbank.ae/en/pdf/Law-10-English.pdf. [Accessed: 10 June 2012].
244 Bundhun, R. (2011) *Rise of the UAE as a banking superpower*. 22 November 2011. [Online] available from: http://www.thenational.ae/news/uae-news/rise-of-the-uae-as-a-banking-superpower. [Accessed: 30 December 2012].

representative offices of foreign banks. It acts as the Bank of the government of the UAE including monetary and financial advice to the government of the UAE.[245]

Successive developments in the economy of the UAE, and the adoption of free market policies and regulations, have led to impressive growth rates and a trend towards sustainable and diversified development. The UAE Government has successfully pursued a strategy to create an enabling business and financial environment that is conducive to economic growth. This has contributed to the world-renowned status of the UAE as an international center for trade, finance and services and has attracted reputable global companies. The UAE has always focused on strengthening its stance as a hub for business. Hence, it demonstrates an exemplary model to be emulated in all patterns of economic development and modernisation. The pegging of the UAE Dirham to the US dollar has introduced a stability in the currency which has not changed over some time. The Fiscal policy of the UAE at both the federal and Emirates level remains prudent. Substantial progress has been made in implementing fiscal management reform.

However, the CBUAE as well as other regulators and policy makers had to deal with the aftermath of the financial crisis systematically to avoid any further systemic meltdowns.[246]Although the UAE was not directly involved in the financial crisis, regulators have learnt to be very cautious. They had to address the high debt burdens and eroded balance sheets of sovereign as well as major financial institutions[247] Therefore, post-financial crisis, the UAE's economy started to recover in 2010 benefiting from higher oil prices and a strong demand from traditional trading partners. Total public revenue had increased from US$68.1 billion in 2009 to US$85.7 billion in 2010 and was estimated to be US$121.8 billion in 2011. This is primarily due to the increase in oil and gas earnings. While public earning has increased in 2009, public expenditure and grants have decreased from US$102.2 billion in 2009 to US$89.6 billion in 2010. It is estimated to be around US$99.5 billion in 2011. As a result of the prudent management of public revenue, the public deficit has declined from 12.9% of the GDP in 2009 to about 1.3% of the GDP in 2010.[248]

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[245] See *ibid.*, and also Centralbank.ae (2012) '*Union Law No. (10) of 1980 Concerning the Central Bank…'*, *supra* note 243.

[246] Arabianmoney.net (2009) *Dubai Economic Council crisis meeting*. [Online] available from: http://www.arabianmoney.net/banking-finance/2009/03/09/dubai-economic-council-crisis-meeting/. [Accessed: 21 April 2013].

[247] See generally, Economic and Social Commission for Western Asia (ESCWA) (2009) *The Impacts of the Financial Crisis on ESCWA Member Countries: Challenges And Opportunities*. United Nations. [Online] available from: http://www.escwa.un.org/divisions/div_editor/Download.asp?table_name=divisions_other&field_name=ID&FileID=1105. [Accessed: 21 April 2013].

[248] Wto.org (2013) *United Arab Emirates and the WTO*. [Online] available from: http://www.wto.org/english/thewto_e/countries_e/united_arab_emirates_e.htm. [Accessed: 31 October 2013].

### 5.2.2 The Ministry of Economy (MOE) [249]

Upon its establishment in 1970 until 2007 the Ministry was in charge of implementing companies law and corporate governance provisions. It also supervises the formation of all types of companies that are regulated under the Federal Law of 1984 Concerning Commercial Companies, as well it regulates IPOs.[250] When the SCA was established in 2000 to act as the supervisory authority over the financial markets, it was apparent that there was an overlap between the responsibilities of the two formerly existing regulators, CBUAE, the MOE; and the SCA. Not to mention that when there was a transition from informal to formal financial markets, there should have been a delegation of the necessary powers from the CBUAE and the MOE to the SCA. For that and in order to maintain a sound regulatory system, the SCA should have been specifically delegated the powers of licensing and supervising financial intermediaries and investment companies as well as the IPOs by Public Joint Stock Companies.

Accordingly, by the end of the year 2006, the CBUAE Board, transferred the authority to register and supervise brokers from the CBUAE to the SCA. This transfer of authority was intended to give the SCA more powers to supervise trading in the markets. Furthermore, the Ministerial Council of Services, in its Decision No. 3/3 of 2007 (2/5/2007), transferred the authority of incorporation and supervision of Public Joint Stock Companies from the MOE to the SCA.[251]

### 5.2.3 The Securities & Commodities Authority (SCA) [252]

The SCA was established on 29 January 2000 under a Federal Law, with the objective of improving the efficiency of the financial markets and protecting investors from unfair and incorrect practices, which had developed during the late 1990s. Before the SCA was set up, there was little price transparency and public disclosure by public companies, which encouraged bad business practices such as insider dealing activities. Prior to the creation of the SCA, the CBUAE assumed the responsibility for securities regulation. Subsequently, this has now been transferred to the SCA as a securities regulator.[253] Moreover, although the Insurance Authority regulates the insurance companies, the SCA

[249] Economy.gov.ae (2013) *Ministry of Economy*. [Online] available from: http://www.economy.gov.ae/Arabic/Pages/default.aspx. [Accessed: 21 April 2013].
[250] UAE Federal Law No. 8 of 1984 Concerning Commercial Companies, *supra* note 65.
[251] For more details, see Albelooshi, A. (2008) The Regulation of Insider Dealing: An Applied and Comparative Legal Study towards Reform in the UAE. *PhD Thesis*. United Kingdom: University of Exeter. 84-85.
[252] The Securities & Commodities Authority, *supra* note 76.
[253] On 24th February 2009 both the Central Bank of UAE & the SCA have jointly entered into Memorandum of Understanding to determine responsibility of each party in relation to legislation, licensing, supervision and inspection on some activities respectively concerned with the financial services sector, where it is aiming at enhancing better control on risks that may be encountered by such sector. For further details on the MOU, see Sca.gov.ae (2012) *MOU signed between Central Bank of UAE and the SCA*. [Online] available from: http://www.sca.gov.ae/english/news/pages/2009-02-25-2.aspx. [Accessed: 10 October 2012].

share the responsibilities of oversight over those companies being listed companies on the exchanges.[254]

The main functions of the SCA are to propose and issue regulations; supervise two securities exchanges and one commodities exchange; license the markets and brokers; authorise the listing of securities and commodities derivatives for trading; supervise and regulate the brokers; financial advisors; custodian; market makers; regulate and monitor the disclosure of information relating to securities; and determine, in consultation with the markets, the fees. The SCA has regulatory oversight of publicly listed UAE companies listed on the two securities exchange as well as the sale of foreign securities onshore in the UAE. The SCA has comprehensive laws and regulations that ensure that it is enabled to undertake the necessary steps to improve the efficiency of the UAE's financial markets and to protect the integrity of those markets and defend the interests of all classes of investors. It also has the ability to be in contact with international markets in order to obtain and exchange information and expertise, and to join relevant Arab and international organisations and federations. In the event that it is required, the SCA can also halt trading temporarily in the securities market in exceptional circumstances or in an event which threatens the proper and regular working of the market. It can also freeze, suspend or bring back into force any rules and regulations relating to the market or any of its operations; compel natural or juristic persons having a connection with activities in securities to make public disclosure and submit any information related to their activities.[255]

Through a combination of rotational on site visits and remote electronic transaction monitoring both the exchanges' regulators and the SCA are able to satisfy themselves that the firms and other market participants are complying with the relevant laws and regulations. Besides the trading surveillance departments at the securities exchanges, the SCA has its own trading surveillance department to make sure that trading activity falls within proper parameters. Along that line, the SCA has signed a Memorandum of Understanding with ADX and DFM specifying the surveillance responsibilities of each of these exchanges.[256]

### 5.2.4 The Dubai Financial Services Authority (DFSA)[257]

The UAE's many approaches to further diversify away from the oil and gas industry took place in 2004 through the creation of the first financial free zone in the UAE with a regulatory structure modeled on best practices followed in major international markets such as New York, London, Singapore and Australia. Therefore, one of the Supreme Federal

[254] The insurance sector in the UAE is regulated by Federal Law No. 6 of 2007 on Establishment of the Insurance Authority. See Ia.gov.ae (2014) *Federal Law No. 6 of 2007 on Establishment of the Insurance Authority & Organization of its Operations*. February 2007. [Online] available from: http://www.ia.gov.ae/en/Documents/Federal%20Law%20No.6%202007.pdf. [Accessed: 20 March 2013].
[255] See the SCA Federal Law No. (4) of 2000 Concerning Emirates Securities, *supra* note 75; and the SCA Rules and Regulations, *supra* note 3.
[256] Sca.gov.ae (2013) *Bilateral MOUs*. [Online] available from: http://www.sca.gov.ae/English/internation relations/sca_mous/Pages/default.aspx. [Accessed: 10 December 2013].
[257] Dfsa.ae (2013) *Dubai Financial Services Authority*. [Online] available from: http://www.dfsa.ae/Pages/default.aspx. [Accessed: 22 November 2013].

Council's decision making powers was the creation of the Dubai International Financial Centre (DIFC)[258] and the Dubai Financial Services Authority (DFSA).[259] Creating the DIFC and the DFSA required a unique legal and regulatory framework, made possible through a synthesis of Federal and Dubai law.[260]

The DFSA is the independent regulator of all financial and ancillary services conducted through the DIFC, a purpose-built free-zone in Dubai. The DFSA's regulatory mandate covers asset management, banking and credit services, securities, collective investment funds, custody and trust services, commodities futures trading, Islamic finance, insurance, an international equities exchange and an international commodities derivatives exchange. The DFSA is also responsible for the regulation and supervision of persons in the DIFC in relation to anti-money laundering, counter-terrorist financing and sanctions compliance. The DFSA's stated approach is to be a risk-based regulator and to avoid unnecessary regulatory burden. Regulation is being directed to the mitigation of risks that would otherwise be unacceptable. Compliance obligations should be proportionate to the mitigation of those risks within a framework that enables regulated entities to effectively and efficiently meet their compliance obligations.In fulfilling its mandate as the sole independent financial services regulator for the DIFC, the DFSA performs a number of functions including policy, rulemaking, authorisation, supervision and enforcement. The FSA had signed an MOU with the SCA on 2005 for mutual cooperation, assistance, training purposes, and conducting joint inspection with the SCA on brokerage and commodities firms working in both jurisdictions.[261]

## 5.3 The Markets Regulated by the SCA and the DFSA

Relatively speaking, the financial markets in the UAE are at a nascent stage of their development. Along with the two securities exchanges that were formed in 2000, the DFM[262] and ADX.[263] The Dubai Gold & Commodities Exchange (DGCX)[264] is a company majority

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[258] The DIFC was established pursuant to UAE Federal Decree No. 35 of 2004, UAE Federal Law No. 8 of 2004 and Dubai Law No. 12 of 2004. It occupies a physical territory of approximately 110 acres.The DIFC is a federal financial free zone situated in the Emirate of Dubai. It has its own legal system and courts distinct from those of the wider UAE, with jurisdiction over corporate, commercial, civil, employment, trusts and securities law matters. See Difc.ae (2014) *Dubai International Financial Centre*. [Online] available from: http://www.difc.ae. [Accessed: 19 May 2014].

[259] The DFSA, *supra* note 257.

[260] The Federal Law No. (8) of 2004 was proposed by the Minister of Economy and the Minister of Finance and Industry and approved by the Cabinet, the Federal National Council and ratified by the Supreme Federal Council. This Law covered the Financial Free Zones in the UAE and was gazetted on 27 March 2004. It allowed a Financial Free Zone to be established in any emirate of the UAE, by Federal Decree. Importantly, it exempts Financial free Zones from all Federal, civil and commercial laws. UAE criminal law still applies. Hence, the DIFC was empowered to create its own specific legal and regulatory framework for all civil and commercial matters.

[261] The SCA Bilateral MOUs, *supra* note 256.

[262] DFM *supra* note 70.

[263] ADX *supra* note 72.

[264] Dgcx.ae (2012) *About DGCX*. [Online] available from: http://www.dgcx.ae/index.php/en/home-1/about-dgcx. [Accessed: 18 November 2012].

owned by Dubai Multi Commodities Centre (DMCC)[265] a free zone authority and strategic initiative of the government of Dubai. Although the DGCX is established as a free zone company, to be located within the DMCC free zone which is beyond the legal jurisdiction of the SCA, it chose voluntary to be licensed and regulated as a commodities derivatives exchange by the SCA through signing an MOU for that purpose.[266] Its mandate to enhance commodity trade flows through the Emirate by providing the appropriate physical, market, financial infrastructure and services required. The DGCX commenced trading in November 2005 as the regions first commodity derivatives exchange. The Management team of DGCX comprises senior personnel from the commodities, securities and financial services industries bringing a wealth of experience and expertise to ensure the success of DGCX.

Another exchange that is located in the DIFC is Nasdaq Dubai, an exchange that is regulated by the DFSA as an Authorised Market Institution (AMI) under the DIFC Regulatory Law. Nasdaq Dubai is the international financial exchange in the Middle East.[267] However, following the DFM's announcement in December 2009 of its intention to fully acquire Nasdaq Dubai, the DFM commenced an outsourcing agreement with Nasdaq Dubai, in which the trading, clearing, settlement and custody of Nasdaq Dubai securities will operate through the trading platform of DFM, the majority shareholder of Nasdaq Dubai.[268] Although securities on DFM are quoted, traded, cleared and settled in UAE Dirham, Nasdaq Dubai securities are quoted, traded, cleared and settled in US Dollars. Despite the above arrangement between the two markets, Nasdaq Dubai remains subjected to the laws and regulation of the DFSA.

## 5.4 Selective Regulations of Securities Markets

The SCA issued many rules and regulations that it considers necessary and prudent for the running of a functional and safe equity market.[269] These include the regulations as to the listing of securities on the exchanges, as to the trading of commodities and commodities contracts, as to the functioning of the securities & commodities authority, as to brokers, as to membership of the market, as to disclosure and transparency, as to the arbitration of disputes arising from the trading of securities and commodities, as to trading, clearing, settlement, transfer of ownership and custody of securities, as to the functioning of the market, as to the listing of foreign companies, as to the listing of Islamic bonds and debt securities, as to safe custody activities, as to rules and accounts separation mechanism at the brokerage firms, as to margin trading, as to dual listing, as to financial consultancy & financial analysis, as to custody activities, as to delivery vs. payment (DVP) mechanism, as to market maker, as to

[265] See Dmcc.ae [2014] *Dubai Multi Commodities Centre*. [Online] available from: http://www.dmcc.ae. [Accessed: 11 June 2014]; andSca.gov.ae (2015) *SCA signs MOU with DMCC*. [Online] available from: http://www.sca.gov.ae/English/news/Pages/2015-01-18.aspx. [Accessed: 10 February 2015].
[266] The SCA Bilateral MOUs, *supra* note 256.
[267] See Nasdaq, *supra* note 43.
[268] Dfm.ae (2010) *DFM welcomes trading of NASDAQ Dubai securities through its trading platform*. July 2010. [Online] available from: http://www.dfm.ae/documents/News%20Files/87d009f7-e1c3-4ac4-9119-9f042d28de49.doc. [Accessed 30 May 2013].
[269] See the SCA Rules and Regulations, *supra* note 3.

securities lending and borrowing, as to securities short selling, and as to liquidity provision.[270] With the introduction of the new legislation of the SCA Board Decision No. (37) of 2012 concerning the regulations of mutual funds, the SCA became the licensing authority for investment funds, which were historically regulated by the CBUAE.[271] The rules would enhance transparency and oversight of funds for the mass market in the UAE.[272]

### 5.4.1 The Regulations of Disclosure and Insider Dealing

The disclosure rules applicable to the UAE markets have two primary sources. The first is a statute, namely, the Federal Law of 2000 under Chapter Five, which is entitled "Disclosure and Transparency." [273] The SCA had been endowed with a variety of regulatory and enforcement responsibilities, including the ability to compel virtually anyone connected with the UAE securities markets to produce any information that the SCA believes may be relevant to carrying out these responsibilities. The SCA also has investigatory authority over the markets and market participants.

The Law requires that all companies with listed securities in the UAE markets promptly notify the market of any developments or information that may affect the prices at which their securities are traded. The market has the ability to require that any company with listed securities make public, and publish, any explanatory information relating to the company's activities. It may also, in its discretion and depending on what it perceives to be the needs of the marketplace, publish any information that it receives in the local press and other media. Requests are generally made to companies under the provision of the Federal Law when the SCA perceives that the markets are not behaving rationally, and that the underlying problem stems from confusion about some event or circumstance affecting a given company that investors either do not know about, or cannot analyse because they do not have sufficiently complete information. It is unlawful for a listed company to respond by furnishing false or misleading information that could affect stock prices, or the decision by investors about whether or not to invest.[274]

As the above Law set forth the broad parameters of disclosure and transparency, the second detailed source that covers the same subject matter area is the SCA own Regulations as to Disclosure and Transparency No (3) of 2000.[275] The Regulations seek to cover various pre-listing matters, post-listing matters, and also certain aspects of the conduct of the securities brokerage business. The aim of the Regulations is "to secure the integrity and accuracy of transactions...," and so forth. The shorter version is that the Regulations seek to

[270] *Ibid*.
[271] See the MOU between the Central Bank of UAE and the SCA, *supra* note 253.
[272] Sca.gov.ae (2012) *The Regulations on Mutual Fund*. [Online] available from: https://www.sca.gov.ae/English/legalaffairs/New%20Laws/041.pdf. [Accessed: 7 November 2012].
[273] The SCA Federal Law No. (4) of 2000 Concerning Emirates Securities, *supra* note 75.
[274] Articles 33, 34, 35 respectively, *ibid*.
[275] Sca.gov.ae (2000) *SCA Board Decision No (3) of 2000 Concerning the Regulations as to Disclosure and Transparency*. [Online] available from: https://www.sca.gov.ae/English/legalaffairs/Pages/default.aspx. [Accessed 28 December 2012].

make certain that all of the players in the securities markets have the benefit of the proverbial level playing field, so that everyone who is interested has access to the same information as everyone else. The other word for this is "transparency."

The SCA's Regulations establish various required pre-listing disclosures to which companies must adhere as a condition to obtaining the SCA's required approval for the listing of their securities on the public trading exchanges. Once such approval is obtained and the securities become listed, the Regulations also establish various post-listing requirements. These are primarily reporting requirements that are ongoing obligations of the company for so long as its shares remain listed, in order to enable the SCA to better monitor developments in the markets and to ensure full transparency. One of the post-listing Regulations which is of very great interest to actual and prospective investors deals with the disclosure of who really owns and controls the issuer company. Anyone who directly or indirectly owns 5% or more of the shares of a company must immediately notify the market on which the shares are traded of this fact. The same requirement exists as to parent, subsidiary, affiliate, and allied companies of the issuer, except that the disclosure requirement is not triggered until the percentage of ownership reaches 10%.[276]

The SCA's Regulations are also designed to detect early possible developing takeover attempts of publicly-traded companies by requiring the owners of 10% or more of an issuer to first notify the relevant market authority if they desire to increase their ownership to 20% or more. The market authority may prohibit the transaction if it would tend to prejudice 'the interests of the national economy.' Also, the CBUAE must approve the acquisition of 5% or more of the shares of any publicly traded bank.[277] The SCA also has the lawful authority to inspect the records and operations of 'Market Members,' either by itself or in cooperation with the particular market's overseeing authority, in order to make certain that issuer companies are in full compliance with all laws, regulations, and rules to which they are subject.[278]

The SCA itself is not immune from its own Regulations. It is prohibited from carrying on any commercial activities for its own benefit, and it cannot own, hold, or issue any securities. The members who comprise the SCA's board of directors are permitted to trade in the securities markets, but must immediately disclose upon assuming office the full nature of their securities holdings, whether these holdings are in their own names or are held indirectly, such as through a spouse or minor child. Upon taking office, any future transactions that result in changes in a board member's holdings must be fully disclosed and reported to the SCA within a period of one week. Any board member of the SCA who is either convicted of an 'offence of dishonor' or who commits a breach of trust, or who declares bankruptcy, is automatically removed from the board.[279] Provisions such as this, along with the previously-discussed constraints on the activities of the SCA directors, are designed to

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[276] Article 3 of the SCA Regulations as to Disclosure and Transparency, *supra* note 275.
[277] Articles 6, 7 respectively, *ibid*.
[278] Article 9, *ibid*.
[279] Articles 10, 11, 12 respectively, *ibid*.

assure investors and the general public of the agency's absolute integrity. This is especially important given the SCA's broad powers.

The SCA has the power to suspend the listing of a company's securities under a broad array of circumstances. Three common scenarios that typically bring about a suspension of trading are when a company's general assembly decides to reduce the company's capital, where the company fails to issue the periodic reports regarding its activities and financial condition that are required by law and regulation, and where a general assembly decides to sell a substantial portion of the company's assets.[280] None of these events usually represents good news for existing investors, and dictate at least the SCA to inquire into what exactly is really going on before trading can be allowed to resume.

The SCA can also cancel, rather than just suspend, a company's listing of its securities under certain extreme circumstances. Three that are regarded as being especially severe are when the company passes a resolution to dissolve and liquidate, or its listing remains suspended for six or more months, or where the company radically changes its primary business activity. The latter rule is designed to prevent situations that would enable companies to obtain listing permission 'by stealth.' In such a case, the considerations that first led to listing approval might very well not apply at all to the subsequently-announced, real nature of the business.[281] Listing cancellation can also be brought about if the issuer discontinues its business activity, or if the company is merged under a structure that brings its 'juristic personality' to an end. Under most merger structures, the companies involved end up being either a 'surviving corporation' or a 'disappearing corporation. 'Cancellation of previously-listed securities is almost always imposed when the issuer turns into a 'disappearing corporation.'

It is also important to note that under the SCA's Regulations, it is not only issuer companies that are obligated to report significant information and events to the SCA; the markets themselves are also similarly obligated.[282] The SCA's Regulations specify that the markets themselves are responsible to issue whatever press and media notices may be necessary in order to ensure transparency and the full disclosure of material information. Further, each market must furnish to the SCA, within one month from the close of its financial year, its balance sheet, profit and loss account, and annual audited financial statements. The SCA's periodic reporting requirements that are applicable to issuers of securities are likewise applicable to the individual markets themselves.

Those responsible for managing the markets themselves are also screened by applicable SCA Regulations in order to avoid conflicts of interest. Board members of joint stock companies, financial brokers, and representatives of financial brokers cannot simultaneously serve on the board of directors of any of the markets. The same disclosure and reporting requirements mentioned earlier as being applicable to members of SCA's own board are likewise applicable to members of the Boards of each of the markets, as well as

[280] Article 14, *ibid*.
[281] Article 15, *ibid*.
[282] Articles 18, 25, *ibid*.

other managerial market 'insiders. 'Market board members are, just like the SCA's board members, automatically terminated upon conviction of an offence of dishonour, breach of trust, or the declaration of bankruptcy.[283]

Mid-month as well as monthly reports on trading activities are also required to be filed by each of the markets with the SCA. An extremely comprehensive annual report to the SCA is also mandatory. Besides their other reporting obligations, the markets are also obligated to furnish the SCA with what is known as a 'Daily Price Bulletin.' [284] This report is primarily devoted to reporting on securities prices and, more importantly, significant changes in prices during the course of the day. Such changes are often indicative of the beginning or end of particular trends, many of which relate to market stability and volatility, and are therefore of particular interest to the SCA as the markets' primary regulatory authority.

Because of their unique and significant role in the marketplace, securities brokers and their representatives have been made subject to special Regulations promulgated and overseen by the SCA. Like all other market participants, these parties are precluded from trading based on beneficial inside information, are restricted from becoming affiliated with securities issuers, and in general are subject to the same restraints on trading activities as are investors. The SCA Regulations further prescribe standards for matters such as capital adequacy, restrictions on foreign ownership, and the qualification of management members of brokers and their representatives.[285]

Both the Law first adopted in 2000 as well as the Regulations establish that a number of violations of the rules of the securities business can be treated as criminal offences. Penalties that can attach include imprisonment for up to three years per offence, fines of up to 1 million Dirhams, and combinations of prison terms and fines. Besides potential criminal penalties, the SCA may also, in the event of securities law or regulatory violations, impose administrative sanctions through the levying of monetary (civil) penalties as well as by barring any investor from trading in the marketplace for a period of up to one year. Both penalties may be imposed simultaneously.[286]

In its monitoring activities, the SCA compiles and publishes periodic data from all of the UAE markets, and makes available reports such as the 'Shares Proprietorship Ratio.' It also publishes news items that are of particular interest to securities market participants, and maintains a fairly extensive website on which laws, regulations, market developments, price information, and other matters of interest are disseminated.[287]

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[283] Articles 22, 23, 24 respectively, *ibid*.
[284] Articles 26, 27, *ibid*.
[285] Article 17 of the SCA Decision No. (27) of 2014 Concerning Brokerage in Securities. See Sca.gov.ae (2014) *SCA Board of Directors Decision No. (27) of 2014 Concerning Brokerage in Securities*. [Online] available from: http://www.sca.gov.ae/English/legalaffairs/LegalLaws/AmendedRules/2000_1_R.pdf. [Accessed: 24 February 2014].
[286] See Articles 41 & 42 of the SCA Federal Law No. (4) of 2000, *supra* note 75; and Article 37 of the SCA Disclosure and Transparency Regulations of 2000, *supra* note 275.
[287] See Esm.sca.ae (2014) *Report Center*. [Online] available from: http://esm.sca.ae/English/Pages/Report Center.aspx. [Accessed: 10 March 2014].

The SCA endeavors to keep its finger on the pulse of the market by routinely analysing the numerous company and market reports and other sources of information that are filed with it or otherwise brought to its attention. It also interacts with other UAE governmental agencies and institutions, such as the CBUAE, in order to maintain a proper perspective on market activities and foster the free exchange of information between different agencies who have reasons to be interested in market events and conditions.

Broker and broker representatives oversight and monitoring is also one of the SCA's key missions. Trading and settlement procedures, as well as the responsibilities imposed on investors, are all subject to the SCA's continuous oversight and monitoring activities. In addition, previously unavailable information is now freely accessible by anyone via the Internet, including: disclosure of insider transactions; disclosure of statistics relating to majority shareholders; disclosure of trades by issuer directors and employees; and disclosure of relative ownership percentages by nationals versus foreign nationals.[288]

The regulation of timely disclosure in local financial markets in the UAE, falls under the SCA Federal Law[289] and its Disclosure and Transparency Regulations.[290] The Regulations consist of the three following articles. Article 33 indicates that the company or entity (i.e. the issuer) whose securities have been listed in the Market is obliged to notify the SCA and the market of "any significant developments affecting the prices of such securities upon learning of the same." It also used some non-exhaustive examples of events in which the issuer should make timely disclosure. The Article is also giving the market the right to publish any statement in respect of the disclosed information.

Additionally, Article 34 is directed to circumstances in which the issuer is requested, by the market, to publish any explanatory information or press announcement which relates to its circumstances and activities. This is to secure the integrity of transactions and the confidence of investors, especially when there is a need to answer rumours in the market. In contrast, Article 35 provides an exemption where issuers can delay disclosure of information to protect the business, and where there has not been, nor will be, any dealing in its shares by members of its board of directors and executive managers and their relatives to the first degree by members of its board of directors and executive managers and their relatives to the first degree on the basis of the information not announced to the public, provided that the company furnishes to the director of the Market such information and data specifying the persons aware of such information, and, requesting him to consider it confidential until the grounds which gave rise to that no longer subsist. However, the Market may, in coordination with the SCA, accede to such request or compel the company to announce the information and data if they consider that the revealing of such information will not affect the interests of the company or feel that there is a leakage of the related information and data which the company considers confidential.[291]

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[288] For that see DFM and ADX websites, *supra* notes 70 & 72.
[289] Chapter Five, Articles 34-36 of the SCA Federal Law No. (4) of 2000, *supra* note 75.
[290] Articles 33-35 of the SCA Regulations as to Disclosure and Transparency, *supra* note 275.
[291] *Ibid*.

Again, in regards to the regulation to the insider dealing, the Federal Law of 2000 also addressed the prohibition of insider dealing as indicated below.[292]

Article 37 defines inside information as:

> "The exploitation of undisclosed information which could affect prices of Securities in order to achieve personal benefits shall not be permitted. Any dealing effected in contravention of this shall be null and void."

Article 39:

> "It shall not be permitted for any person to deal in Securities on the basis of unpublicised or undisclosed information he acquired by virtue of his position.It shall not be permitted for any person to spread rumours regarding the selling or buying of shares.Nor shall it be permitted for the chairman and members of any company's management or its employees to exploit their inside information as to the company in the purchase of shares or the sale thereof in the Market.Any transaction effected by any person in contravention of the provisions of the two preceding paragraphs shall be null and void."

Accordingly, the SCA Disclosure and Transparency Regulations of 2000 implemented the above-mentioned Articles under the SCA Law, and stipulated the punishments for market abuse. The three Articles are as follows: [293]

Article 37:

> "1- Pursuant to Federal Law No. 4 of 2000 concerning the Emirates Securities & Commodities Authority and Market, any person shall be liable to imprisonment for a period of not less than three months and not more than three years and a fine of not less than one hundred thousand (100,000) Dirhams and not more than one million (1,000,000) Dirhams, or either of these penalties, if he:
> a. Furnishes any data, or proffers any declaration or information being untrue and such as to affect the market value of the securities and an investor's decision to invest or otherwise.
> b. Deals in securities on the basis of unpublicised or undisclosed information he acquired by virtue of his position.
> c. Spreads tendentious rumours regarding the selling or buying of shares.
> d. Exploits unpublicised information which could affect the prices of securities to achieve personal benefits.
> Any dealing or transaction effected on the basis of the preceding shall be null and void.

[292] Articles 37, 39 respectively of the SCA Federal Law No. (4) of 2000, *supra* note 75.

[293] Articles 37, 38, 39 (1) of the SCA Regulations as to Disclosure and Transparency, *supra* note 275. Similarly, Articles 15, 16 and 17 of Regulation as to Trading, Clearing, Settlement and Transfer provide for an annulment of certain transactions. See Sca.gov.ae (2001) *SCA Board Decision No (2/R) of 2001 Concerning the Regulations as to Trading, Clearing, Settlement, Transfer of Ownership and Custody of Securities.*[Online] available from: https://www.sca.gov.ae/English/legalaffairs/New%20Laws/035.pdf. [Accessed: 7 June 2012].

Article 38:

> "The chairman and the members of the board of directors of a company whose securities are listed in the Market and its general manager and any of its employees shall be liable to imprisonment for a period of not more than three years and a fine of not less than one hundred thousand Dirhams and not more than one million Dirhams, or to either of these penalties, if he effects dealings through himself or through others in any transaction in the securities of the company, before disclosing to the Market the purchase or sale transaction, the quantities and prices thereof, and any other information required by the Market, and the obtaining of the approval of the Market's board of directors for such transaction. Any transaction not effected pursuant to such disclosure shall be null and void."

Article 39:

> "Any chairman and any of the members of the board of directors of any company or any of its employees who exploits his inside information as to the company in the purchase of shares or the sale thereof in the Market shall be liable to imprisonment for a period of not less than three months and not more than three years and a fine of not less than one hundred thousand Dirhams and not more than one million Dirhams, or either of these penalties. Any transaction so effected shall be null and void."

Moreover, the SCA has also prohibited certain transactions by company insiders by establishing time frame constraints during which such insiders may not trade in their company's listed securities. Specifically, in the 15-day periods that precede the holding of an issuer's general or extraordinary general assembly, or the announcement of information of a nature such that it would affect the company's share price either favorably or adversely, or the date of announcement of the company's annual or interim financial statements, trading by insiders in the issuer's stock or in the stock of its parents, subsidiaries, associates, or sister companies is prohibited. There is an unstated presumption that during these periods, any trade by an insider is deemed to be tainted by virtue of the inescapable existence of insider information.[294]

### 5.4.2 The Regulations of Corporate governance [295]

Generally, the UAE regulatory framework of corporate governance comprises of three components: Federal Law No. 8 of 1984 Concerning Commercial Companies; the SCA Decision concerning Disclosure and Transparency, and the Code of corporate governance. These components, collectively, provide a comprehensive account of the UAE corporate

[294] *Ibid*., Article 14.

[295] Sca.gov.ae (2012) *Ministerial Resolution No. (518) of 2009 Concerning Governance Rules and Corporate Discipline Standards.* [Online] available from: http://www.ecgi.org/codes/documents/ministerial_resolution_uae_29oct2009_en.pdf. [Accessed] 19 May 2014].

governance practices.[296] In regards to the disclosure obligations under the Code, they are as follows:[297]

#### 5.4.2.1 The obligation 'to disclose' when there is a conflict of interest

The Commercial Companies law requires each board member in the company who has a conflict interest with the company's interest in an operation presented to the Board of Directors for approval, to inform the board of so, and to register his acknowledgement in the minute of the meeting. This member may not participate in voting on the resolution issued regarding this process .[298]

However, the legislator wanted in the Code to expand on the commitment of the parties related to the disclosure. Among them, of course, the members of the board, where the Code does not only regulate their disclosures, according to Article 3(10),[299] but it expanded the scope of disclosure and persons covered with his provisions, namely, the disclosure of related parties which will be discussed further below.

#### 5.4.2.2 Disclosure of Related Parties

The Code defined the relevant parties as the "chairman and members of the board of directors and members of the senior executive management, and companies in which any of them have a controlling stake, parent companies or subsidiaries or sisterly or allies." [300] It

[296] Hassan, M. K. (2011) Corporate Governance Practices in Emerging Economies: Initial Findings From the UAE. *China-USA Business Review*. Volume 10. No. 9. 856-864. Notably, there are different codes of CG in the UAE. The CBUAE has issued binding and non-binding guidance, in 2006, in relation to corporate governance within regulated institutions. By Circular 23/00, it issued binding recommendations for corporate governance structures in UAE banks (the CB Rules) and additional non-binding guidance for bank directors was issued in its Corporate Governance Guidelines for Bank Directors (the CB Guidelines). See Centralbank.ae (2014) *Corporate Governance Guidelines for UAE Bank Directors (Draft)*. June 2006. [Online] available from: http://www.centralbank.ae/pdf/Draft-CGGuidlines.pdf. [Accessed: 4 October 2014]. Also, the DIFC Markets Law, which is administered by the DFSA imposes corporate governance requirements on firms licensed to provide financial services in the DIFC and companies listed on Nasdaq Dubai, see Dfsa.ae (2013) *General Module (GEN) Instrument.* No. 119, 2013. [Online] available from: http://dfsa.complinet.com/net_file_store/new_rulebooks/d/f/DFSA_RM119.pdf. [Accessed: 3 March 2014]. Recently, the MOE had issued Ministerial Resolution No. 228 of 2015 Concerning Corporate Governance Rules and Corporate Discipline Standards that applies to private joint stock companies. Lastly, the Emirate of Abu Dhabi established the Governance Committee through Resolution No. 17 of 2010 to supervise the implementation and development of concepts and frameworks of governance in the public sector. For that see Adaa.abudhabi.ae (2014) *2014 Accountability Report.* [Online] available from: http://www.adaa.abudhabi.ae/En/Publications/Publications/Accountability%20Report%202014.pdf.[Accessed: 3 March 2014].

[297] For more details, see Abdel Moniem, A. A. (2014) *Corporate Governance in the UAE Legislation*. Abu Dhabi: Judicial Department. 146-55.

[298] Article 109 of Federal Law No. 8 of 1984 Concerning Commercial Companies, *supra* note 65.

[299] The Article states: "In case a board member is a subject to conflict of interest in an issue to be considered by the board of directors and the board resolves that it is a material issue, the board resolution shall be issued at the attendance of majority of members and such interested member may not vote over the resolution. In exceptional cases, these issues may be handled through board subcommittees formed for this purpose by a board resolution and the committee's opinion shall be referred to the board of directors to make a decision in this regard." Article 3(10) of Resolution No. (518) of 2009 Concerning Governance Rules, *supra* note 295.

[300] Article 1, *ibid*.

seems clear from this definition that the legislature in the Code wanted to distinguish between the related parties and the stakeholders, where the code defined the stakeholders as: every person who has an interest with the company, such as: shareholders, employees, creditors, customers, suppliers, and potential investors. It can be also seen that the definition of stakeholders came broadly, to include every person who has an interest with the company, including the member of the board.

Article 12 (bis/1) of the Code addressed the provisions relating to the related parties, as it stipulates that: [301]

1. If the related party had any dealing with the company, its parent company or any of its subsidiaries or sister companies, and if the value of such dealing is equal to 10% or more of the value of the assets of the company – based on the latest annual or periodical financial statements of the company – such related party shall make immediate disclosure by way of a letter addressed to the board of directors of the nature of such trading, the conditions thereof and all material information in respect of his/its share or shareholding in the two companies involved in the trading or transaction and the extent of his/its interest or benefit, and the board of directors of the company shall make immediate disclosure thereof to the Market. The details of the trading referred to in Clause 1-hereof, the conditions thereof and the Conflict of Interest relating to the related party shall be recorded in the annual financial statements presented to the general assembly, and such financial statements shall be published on the website of both the Market and the company.
2. If the related party fails to disclose his/its transaction referred to in Clause -1 hereof, the board of directors of the company or any shareholder holding 5% or more of the shares of the company may bring a claim against the relevant member of the board of directors or the related party before a competent court requesting such court to suspend the relevant transaction and to compel and direct the member of the board of directors or the related party to pay to the company any profits or benefits realised by him/it.

It is required to comply with the disclosure in the case of the availability of the following conditions:

1. The related party has to be the chairman and members of the board of directors and members of the senior executive management of the company; companies where any of the aforesaid have a controlling share; and parent, subsidiary, sister or allied companies of the company. It includes the relatives of the chairman, a member of the board of directors or of the senior executive management up to the first degree. It also includes the natural person or body corporate who/which was during the year preceding that of the trading a shareholder holding 10% or more in the company or a member of its board of directors or of its parent or subsidiary company.

[301] Article 12 (bis/1), *ibid*.

2. The related party should have an interest or benefit conflicts or may conflict with the company's interests in deal has been or may be between them.
3. The disclosure is to be immediate by a letter addressed to the board of directors informing about the nature of such trading, the conditions thereof and all material information in respect of his/its share or shareholding in the two companies involved in the trading or transaction and the extent of his/its interest or benefit, and the board of directors of the company shall make immediate disclosure thereof to the Market.

The impact of the obligation to disclose is that the financial report prepared by the auditor of the company should include details of this discrepancy and be presented to the ordinary general assembly meeting. Additionally, if the related party was a shareholder in the company, he cannot vote on the resolution issued by the general assembly on the transaction that belongs to him. Where is the impact of non-compliance with the obligation of disclosure is that the board of directors of the company or any shareholder can apply to the competent court to cease offending transaction and to oblige the related party to reimburse to the company any profit had been gained, and the court issues what it consider appropriate in this regard, taking into account not to harm the interests of *bona fide* of the third party, or exposing the company's interests to risk.[302]

## 5.5 The Twin Peaks Regulatory System in the UAE [303]

### 5.5.1 The UAE Financial Structure as a result of Twin Peaks

In July 2012, there were media reports about the UAE moving towards a 'Twin Peaks' model of financial regulation. Such reports described that under this model, the role of the CBUAE will act as the "prudential regulator" of the entire financial system, while the SCA would take on the "Conduct of Business" role and be responsible for market conduct and investor protection for the entire financial sector which may also include the insurance sector and commercial banks.[304]

### 5.5.2 Prudential Regulation–The Role of the CBUAE

Under the 'Twin Peaks' model, the CBUAE will be responsible for prudential regulation of the financial system. It will focus purely on the prudential and systemic side of

[302] *Ibid*. See also Abdel Moniem (2014) *Corporate Governance in the UAE Legislation*, *supra* note 297.
[303] In a number of advanced economies, in particular in Europe, countries are integrating prudential functions into the Central Bank. Some countries have adopted some form of "twin peaks" model, leaving conduct-of-business and securities market supervision as a responsibility of a separate agency (the Netherlands, Belgium, France, United Kingdom, and the United States). Ireland has opted for a stronger form of integration where all supervision of markets and institutions is conducted by the Central Bank. See Imf.org (2013) *United Arab Emirates: Selected Issues*. IMF Country Report No. 13/240. July 2013. [Online] available from: http://www.imf.org/external/pubs/ft/scr/2013/cr13240.pdf. [Accessed: 16 August 2014].
[304] *Ibid*. See also Khaleejtimes.com (2012) *Proposals adopted to insulate UAE from global crises*. 24 May 2012. [Online] available from: http://www.khaleejtimes.com/kt-article-display-1.asp?xfile=data/uaebusiness/2012/May/uaebusiness_May393.xml&section=uaebusiness. [Accessed: 14 September 2014].

the financial institutions, including entities active in the insurance and securities sectors. Prudential supervision will focus on the solidity of financial enterprises and their contribution to the stability of the financial sector. The CBUAE shall be required to exercise the prudential supervision of financial enterprises and to decide on the admission of financial enterprises to the financial markets.

### 5.5.3 Regulation of Conduct of Business (COB) -the Role of the SCA

Conduct of business supervision shall focus on orderly, transparent financial market processes, integrity in relations between market parties and due care in the provision of services to clients. The primary purpose of conduct of business rules is to set business standards for various aspects of a firm's relationships with their customers. The UAE's new financial structure will have a key role in delivering and supporting its consumer protection objectives by setting standards for firms dealing with customers in three main areas: fair dealing by firms when they advise customers or manage investments for them; information, so that customers can make informed choices; and protection, of customers money and assets.

Conduct of business rules bring needed transparency to the market and seek to ensure that customers in transactions are treated fairly. The standards are intended to establish a framework that protects investors and also promotes efficiency, competition, and capital formation. As a result of this new Twin Peaks structure, the SCA (which might be renamed as Emirates Financial Services Authority or EFSA) will be required to exercise the supervision of conduct of the financial markets and to decide on the admission of financial enterprises to those markets. It is also envisaged that the Insurance Authority will be abolished and that the prudential aspects of the regulation of the insurance companies will become the remit of the CBUAE whilst COB will be part of EFSA's job. However, currently, all rules and regulations relating to these changes are under draft and require approval from the government to proceed.

### 5.5.4 The Advantages of the Twin Peaks Approach to the UAE

The advantages to the UAE are of many folds and are primarily focused on "regulation by objective." The CBUAE's regulatory objective will be prudential supervision with the primary goal of safety and soundness and the SCA's (EFSA) goal will focus primarily on business conduct and consumer protection issues. This allows for clear focus. The Twin Peaks approach is also considered to ensure an appropriate degree of protection for consumers, market integrity, and consumer protection receive sufficient priority. The model may help insulate prudential supervisors from an overly intrusive consumer-oriented approach. When safety and soundness mandates conflict with consumer protection issues, the prudential supervisor may give precedence to safety and soundness mandates, because these are closely intertwined with financial stability. This promotes balance.[305]

This approach is designed to ensure that sales practice protections apply uniformly across all financial products, regardless of the legal status of the entity selling the product with emphasis on consumer protection issues, particularly for retail customers. Under this approach, each regulator can hire employees with appropriate expertise for their specific functions. Prudential regulators can employ persons with business and economic expertise while business conduct regulators focus on hiring enforcement oriented staffs. Having the twin peaks functions in separate entities can minimise conflicts between the two authorities and maximises economies of scale and improves accountability. It also allows rapid policy responses and ensures that regulatory frameworks keep pace with dramatic changes and innovations in financial markets. Twin Peaks also facilitates effective coordination among the regulatory agencies, the central banks, and finance ministries.

It is critical to maintain good contacts and interaction at all levels in the agencies, including at the principal level and the operational levels and allows for better monitoring of the financial system. It also reduces the chance of regulatory overlap or blind-spots thus improving information flow and companies can get on with doing business confident that the same rules apply to everybody. Furthermore, it facilitates financial services businesses to operate more profitably and efficiently, while treating customers honestly and fairly. Being in a well-regulated market may also help them do cross-border business whereby all market participants can understand their obligations.[306]

## 5.6 Conclusion

It can be seen from the discussion in this chapter that the UAE's securities markets have evolved from a nascent stage to a more mature phase in a relatively short span of time. Over-the-counter trading gave way to trading in listed securities and markets gained depth and liquidity by the introduction of financial and market services like custody, (DVP) mechanism, market making margin trading, short selling and liquidity providers, etc. The financial market regulatory landscape developed in response to the market's needs, with banking and credit being the earlier activity to be supervised through the formation of the Central Bank and subsequently, as the financial services developed and the securities trading took off – the SCA was formed which matured as a fully functional and well diversified securities regulator.

In step with the international developments in the regulation of the financial markets, even the Twin Peaks model is being adopted which indicates the progressive nature and the developmental approach of the UAE Government whereby the experiments and developments in international best practices are keenly watched and where appropriate, swiftly adopted. However, as will be seen later, improvement is needed in the regulations

[305] Group of Thirty (2008) *'The structure of Financial Supervision Approaches…,' supra* note 179, at 37 & 38.
[306] *Ibid*., 38 & 50.

that deter insider dealing and enforce issuers to make timely disclosure on par with the international standards.

This chapter was the concluded the part of the thesis that is used to introduce the three jurisdictions especially in the areas of regulatory interest. The following chapter will plot the main goal of the thesis, which is to give a full description of the endemic problems in the very goals and objectives of sound regulations will be laid out; in particular, disclosure and transparency issues, systemic risk management, institutional investing and confidence, insider dealing, false accounting, and corporate governance. These issues will be analysed in both KSA and the UAE, then, they will be compared with similar issues in the UK for the purpose of finding solutions and suggesting methodologies to overcome any shortcomings.

## Chapter Six

## Selected Problems common to the Securities Markets of the United Kingdom, Kingdom of Saudi Arabia and the United Arab Emirates

Based on the discussions in the previous Chapters, this Chapter studies the issues faced by the securities markets and how this was dealt with in each of the three markets. The problems which are common to each market like transparency issues, insider dealing, systemic risk and governance issues are each dealt with independently.

It is well recognised that stock markets perform at least three functions: a signaling mechanism to managers regarding investment, a source of finance, and a catalyst for corporate governance. It is the first function, however, that has attracted a lot of investigation, focusing on whether stock markets invariably encourage corporate managers to take a long-term view of investment rather than permit short term profits. The former perspective is particularly important for efficient investment in a developing country.[307]

It will be seen in this chapter that the markets of KSA and the UAE have shown some weakness in relation to the above as they are still largely closed and family-owned with a narrow concentration of ownership, so stock market developments can ultimately widen the investors' base, separate ownership from control, and in due time inject qualified management to run the affairs of these firms.[308] This chapter addresses number of prominent problems in the two subjective jurisdictions on par with the third jurisdiction, the UK.

### 6.1 The Problems Related to Disclosure and Transparency

Since making money is at the heart of all stock markets, the issue of transparency and disclosure comes hand in hand with financial gain and the securities markets. Individuals and organisations may become obsessed with inordinate needs for materialistic wealth and possessions and do not assume responsibility for maintaining a balance between the good and bad aspects of greed.[309] Hence, the vital and central role of disclosure and transparency enters on-stage to assume, what we hope, would be a central role in minimising greed and improving disclosure as well as transparency and enforcement.[310]

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[307] For a critical view of stock market developments in emerging markets, see Bolbola, A. & Omran, M. (2005) Investment and the stock market: evidence from Arab firm-level panel data. *Emerging Markets Review*. Volume 6. Issue 1. 85-106; and Singh, A. & Weisse, B. (1998) Emerging stock markets portfolio capital flows and long-term economic growth: micro and macroeconomic perspectives. *World Development*. 26 (4). 607– 622.

[308] Jean-Francois S. (1995) The Gulf Capital Markets at a Crossroads. *The Columbia Journal of World Business*. Volume 30. Issue 3. 33, 40.

[309] See Hamilton, S. & Micklethwait, A. (2006) Greed *and Corporate Failure: The Lessons from Recent Disasters*. United Kingdom: Palgrave Macmillan; and Bruhn, J. G. & Lowrey, J. (2012) The Good and Bad about Greed: How the Manifestations of Greed can be used to Improve Organizational and Individual Behavior and Performance. *Consulting Psychology Journal: Practice and Research*. Volume 64(2).

[310] Clements, M. T. (2013) Self-Interest vs. Greed and the Limitations of the Invisible Hand. *American Journal of Economics and Sociology*. Volume 72. Issue 4.

Unlike banking regulation, which primarily focuses on prudential aspects and systemic risk, securities regulation is more concerned with investor protection. In its attempts at protecting the investors, securities regulations should provide appropriate balance between "fairness" among market participants as well as at the same time promote the "efficiency" of securities markets.[311] However, the concept of "fairness" in securities regulations can refer to various meanings that include creating a level playing field, protecting investors from abusive market practices, and resolving potential conflict of interest between market participants.[312]

Hence securities regulation aims at remedying market imperfections, particularly correcting informational distortions caused by asymmetrical distribution of information. Here, the need for timely and adequate information accounts for disclosure being a main tool of securities regulation. However, disclosure is only one of many regulatory tools deployed to achieve investor protection along with other tools such as compensation schemes market monitoring, registration, authorisation, supervision of firms, and corporate governance. The debate in the literature has never been on whether or not information per se is useful to investors. For, no writer has ever contended against better-informed investors. The contention is on whether its provision should be mandated by positive law or be voluntarily left to market forces.[313] However, the overwhelming majority of the literature accepts that when offering securities to the public, mandatory disclosure is by far the primary remedy to many of the shortcomings associated with voluntarily disclosure.[314]

The Secondary Market in the UK covers fixed income, warrants, structured products, ETF's, life insurance products as well as trading in shares on the main exchange, AIM and the OTC derivatives markets. Continuing obligations for listed entities is strict, as are the regulations that ensure licensed firms maintain high standards of disclosure when dealing with their clients and third parties. A Primary Listing on the LSE is considered to be a prestigious event. Admission to listing will potentially permit a company to tap into deep pools of capital both in the UK and Europe. This ability to access cash has huge implications for the companies cost of capital. Primary market listings are also prominent events which are often carefully followed by the media as well as the business community. Disclosure and transparency at a premium or standard listing on the LSE is therefore very strict. Companies

[311] Dattels, P. (1995) The microstructure of government securities markets. Monetary and Exchange Affairs Department. *IMF*. WP/95/117

[312] Long, M. & Vittas, D. (1991) Financial regulation: Changing the Rules of the Game, Country Economic Department. *World Bank*. WPS 803.

[313] See e.g., Coffee (1984) *'Market Failure…'*, *supra* note 107, at 725-30, 740-43; and Dally (2007) *'The Use and Misuse of Disclosure…'*, *supra* note 118, at 1089-1131. For an outline of the arguments against and for mandatory disclosure, see Al-Rimawi, L. (2004) Legal Aspects of Arab Securities Regulation with Particular Reference to Disclosure as a Tool of Investor Protection when Offering/ Listing Shares in Jordan. *PhD Thesis*. United Kingdom: London School of Economics. 45-55, 62.

[314] *Ibid*., 268.

are obliged to disclose all manner of information to the FCA, (previously the UKLA) and to investors via a detailed and comprehensive prospectus.[315]

The rules are stringent and the FCA and the LSE have the right to reject an application if the company does not live up to the required standards. Some of the key disclosure and transparency requirements includes issuers ensuring that they do not provide any misleading, false or deceptive information to the market; any changes to capital structure without first informing the authorities as well as details relating to any changes in the board of directors and senior management and changes in shareholding structure too.[316] Furthermore, post-listing requirements on corporate governance, trading in insider information as well as continuing obligations are rigorous.

However, notably, that one of the objectives of the FSA under FSMA was to promote the UK marketplace. This proved controversial in the last few years because the FSA became very liberal regarding the quality of new issues on the Stock market with some resulting scandals. The problems created by the lack of (or minimal) regulation have been accentuated by the massive growth of the financial centre in London and the tendency that London's low levels of regulations have had to attract even more risky financial institutions. The key point is that regulators whose job is both to promote the market and regulate it face a conflict.[317]

On the other hand, policymakers often claim that transparency in financial disclosures is necessary to prevent sudden steep market declines. Also there were claim that improved financial disclosure results in a reduction in the frequency of market crises. In addition, several papers have examined the relation between financial disclosure and historical stock market crises. Previous research has also examined increases in financial disclosure to see if these increases are associated with reduced information asymmetry and improved stock performance.[318] Overall, results provide some support for the hypothesis that increased information transparency and investor protection rights reduces market volatility and the frequency of large market increases and declines for the sample countries.

Since its inception in the early 17th Century [319] the LSE has faced more than its fair share of scandals and imbroglios. An example to that is the "South Sea Bubble" fever of the 1720's. [320] The South Sea Company had been established almost a decade earlier and had

[315] Notably, the discussion of the primary market is beyond the scope of this thesis. However, see Fca.org.uk (2014) *Listing Rules, FCA, Chapter 1, Section 1.5, Page 9, Standard And Premium Listings*. [Online] available from: http://media.fshandbook.info/content/full/LR/1.pdf. [Accessed: 17 July 2014].

[316] Fca.org.uk (2014) *LR 9.6 Notifications*. [Online] available from: http://fshandbook.info/FS/html/handbook/LR/9/6#D408. [Accessed: 20 June 2014].

[317] Nwankwo, S. & Bill, R. (1996) The UK's privatized utilities experience: why the regulators are under attack. *The International Journal of Public Sector Management*. Volume 9. Issue 3.

[318] For a lengthy examination of all the studies and tests, see Jirasakuldech, B. et al. (2011) Financial disclosure, investor protection and stock market behavior: an international comparison. *Review of Quantitative Finance and Accounting*. Volume 37. Issue 2. 181-205.

[319] See the London Stock Exchange, *supra* note 3.

[320] See Sylla, R. (2005) The First Crash: Lessons from the South Sea Bubble. *Business History Review*. Volume 79 (2); Harrison, P. (2001) Rational equity valuation at the time of the South Sea bubble. *History of Political Economy*. Volume 33 (2). 269-281; and Moneystockstycoons.com (2012) *History of London Stock Exchange*. [Online] available from: http://www.moneystockstycoons.com/stock-market/history-of-london-stock-exchange/. [Accessed: 10 March 2014].

regularly underperformed much to the chagrin of its owners as well as the Government. In an effort then to breathe some fresh life into the firm, the Government issued shares to the public in the form of what would be referred to today as a primary listing which was then followed by a wildly fluctuating speculative period which, according to historical records, was mostly due to overenthusiastic stock brokers speculating and thus pushing up the share price to unrealistic levels. The inevitable collapse wrought carnage on the London financial markets.[321]

Recent and interesting cases of listed entities facing major disclosure and transparency issues include Eurasian Natural Resources Corporation (ENRC) a mining company listed on the FTSE (de-listed as of November 2013) that has recently caused an uproar in the UK parliament amid allegations that its founders skimmed off profits, and that the company lied to investigators and paid off African presidents.[322] Similarly, such notable companies as Shell and Eni are under investigation for payments to Nigeria of US$1.1 billion for offshore oil rights. Such blatant corruption and lack of transparency has been so serious that the British Prime Minister has called for a change in the transparency and disclosure regulations of listed entities to ensure that all "beneficial owners" are correctly identified in the company register. Currently, the beneficial owners of these large corporations can hide under pseudo names and shell companies without anyone actually being able to identify or trace them.[323]

Disclosure is improved *ipso facto*, after that as it is only once a financial *faux pas* or catastrophe has occurred and fallout has damaged enough reputations that governments and regulators furiously go about ensuring that the event never occurs again. Hence a flurry of regulation is passed which may or may not work towards the benefit of the market. The flurry of activity and legislative approvals needed to calm the markets in the 1720's are no different from the same feverish activity that consumed the UK Government and regulators during the global financial crisis beginning in 2008 with the crash of Northern Rock.[324]

Information that investors needed to correctly assess the state of affairs of the markets and in particular financial institutions was not available. The internal mechanics of Northern Rocks precarious financial position were concealed and hidden. Disclosure was poor. Had there been transparency then the potential run on the bank may perhaps have been averted. In

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[321] *Ibid*.

[322] Clearly, this debacle could very well have been one of London's recent encounters with poor disclosure and lack of transparency since the government soon passed regulations to ensure that such a "bubble" did not happen again. See Globalwitness.org (2013) *ENRC listing fiasco sparks vital debate about stock market regulation*. [Online] available from: http://data.parliament.uk/writtenevidence/WrittenEvidence.svc/EvidenceHtml/2333. [Accessed: 6 June 2014]; and Chung, J. (2007) Rigours of the road to a London IPO. *Financial Times*. 14 May 2007. [Online] available from: http://www.ft.com/intl/cms/s/0/4199f35e-01b7-11dc-8b8c-000b5df10621.html#axzz3ERXKfcF6. [Accessed: 15 October 2013].

[323] *Ibid*.

[324] Although Northern Rock was not a particularly large bank (it was at the time ranked 7th in terms of assets) it was nevertheless a significant retail bank and a substantial mortgage lender. See Bruni, F. & Llewellyn, D. T. (ed.) (2009) The Failure of Northern Rock: A Multi-Dimensional Case Study. *The European Money and Finance Forum SUERF*. Vienna. For a detailed time-line on the crises, see also Hamalainen, P. et al. (2011) Did the Market Signal Impending Problems at Northern Rock? An Analysis of Four Financial Instruments. *European Financial Management*. Volume 18. Issue 1. 68–87.

2011, the Chancellor of the Exchequer,[325] George Osborne, supported the proposed notion of "ring-fencing"[326] banks retail assets to ensure that they were fully protected in the event of another meltdown. Similarly, in the US, the Glass-Steagall law required complete separation of investment and commercial banking.[327] Costs will inevitably increase as banks lose the operational and financial efficiencies of being under one roof. Funding for the lending businesses will be used less efficiently and will be more expensive. Ultimately, the cost of credit will go up.

Northern Rock eventually was insolvent because it was hugely over exposed to the mortgage market. As a result of this exposure, individual high street retail customers were seriously affected by the liquidity crunch. Northern Rock was unable to summon sufficient liquidity to cover its deposits. Panic ensued. The run on the bank was the first in the UK in 150 years. Northern Rocks' disclosure issues and lack of transparency were, without a doubt, the main precursor to its demise and subsequent forced takeover by the Government.[328]

The investment and finance sectors in the UK have also been called to improve their own disclosure and transparency. The FCA role is to ensure that licensed individuals operating in licensed firms also conduct themselves in an open and fair manner. In its Handbook,[329] the FCA states that UK disclosure rules are there to ensure implementation of Article 6[330] of the Market Abuse Directive, which specifically refers to the Directive of the

[325] Parker, G. (2011) Northern Rock to set off privatization wave. *Financial Times*. 16 June 2011. [Online] available from: http://www.ft.com/intl/cms/s/0/65c763ca-9794-11e0-9c37-00144feab49a.html#axzz1ewD3cLQ2. [Accessed: 4 January 2015].

[326] Ring-fencing (ring-fence) is also sometimes referred to as "ringfencing" assets was a proposal supported by George Osborne as promulgated in a report issued by the Independent Commission on Banking in 2011. This Commission suggested recommendations to ensure that the retail assets (loan and deposits) of high street banks were protected and "ring fenced" from other operations. This would ensure that individual savers would not lose funds in a meltdown. Ring-fencing has drawbacks, primarily to do with when and how to draw the line between overly protecting savers or deposits holders' accounts and lending out such funds as loans to other businesses. The ring-fence would also have serious implications for investment banking arms of major UK banks since they would be forced to source funding elsewhere as opposed to being traditionally funded via the retail arm. See Independent Commission on Banking Final Report Recommendations(2011), *supra* note 182; and Schwarcz, S. L.(2013) Ring-Fencing. *Southern California Law Review*. Volume 87. 69-110. [Online] available from: http://scholarship.law.duke.edu/cgi/viewcontent.cgi?article=5531&context=faculty_scholarship. [Accessed: 4 January 2015].

[327] The Glass-Steagall Act was passed in 1933 in response to the failure of the banks following the Great Depression. One out of every five banks failed in the aftermath of the stock market crash. Legislators and regulators questioned the role the underwriting of securities played in the financial collapse. Many believed these investment banking activities caused a conflict of interest in that banks often suggested that their customers purchase securities the banks had underwritten. The Glass-Steagall Act forced banks to choose between being a commercial bank or an investment bank, in effect constructing a wall between commercial banking and investing banking activities. For historical perspective opposing and supporting arguments for repeal of Glass-Steagall, see Grunewald, A. E. (1987) Rethinking Glass-Steagall Again: The Glass-Steagall Act. *Business and Society*. Volume 26. Issue 1; and Crawford, C. (2011) The Repeal Of The Glass- Steagall Act And The Current Financial Crisis. *Journal of Business & Economics Research*. Volume 9. Issue 1.127-133.

[328] Stuckler, D. (2008) Can a Bank Crisis Break Your Heart. *Globalization and Health*. Volume 4(1); and Bruni F. (2009) *'The Failure of Northern Rock…'*, *supra* note 324.

[329] Fca.org.uk (2013) *Disclosure Rules and Transparency Rules (DTR)*. [Online] available from: http://fshandbook.info/FS/html/FCA/DTR. [Accessed: 13 December 2013].

[330] Fca.org.uk (2014) *Application and purpose*. [Online] available from: http://fshandbook.info/FS/html/FCA/DTR/1/1. [Accessed: 12 December 2013].

European Parliament and the E.U Council in 2003 on insider dealing and market manipulation (market abuse) and methods of combating and preventing such activity.[331]

The conduct of some members of the Board of Directors and senior management of Northern Rock in 2008 were questionable to say the least. They purposefully and with clear intent refrained from informing the public about certain financial matters that could affect the bank. Likewise, the owners of the South Sea Company in London in 1720, in collusion with the UK Government, refrained from disclosing key information on the performance of the company which eventually led to the share price collapsing.[332]

This event and others have led to lots of changes in the UK financial system. The FCA has now been tasked with overseeing market conduct of licensed firms whilst the PRA will concern itself with overall prudential and systemic risk issues. This departure from the old model to a twin-peak regulatory approach is hoped to increased disclosure and transparency and thus investor confidence. FCA regulations guiding market participants' conduct are outlined in detail in the Business Standards section of the FCA Handbook including conduct of business, client assets and market conduct which contains money laundering regulations and the prevention of insider dealing.

The Code of Market Conduct Handbook ensures that participants maintain open and transparent lines of communication both internally (from a firm perspective) and externally (rest of the market).[333] This was most definitely not the situation in the case of Polly Peck, the once LSE listed textile firm run by Asil Nadir in the early 1980's. Having stolen millions of pounds undetected over the years, as well as being accused of massive insider dealing and manipulation of share prices, Polly Peck's stock finally plummeted in September 1990 as a result of a major investigation by the Serious Fraud Office (SFO) in conjunction with the FSA.[334]

A complete lack of corporate governance, shareholder transparency as well as false and misleading interim financials caused one of the largest scandals in the history of the City. In a bid to avoid this type of manipulation of shareholder and public trust the FCA Handbooks serve as guides for member firms of the stock exchange and also include continuing obligations for listed entities to abide by once floated.

The KSA, Tadawul is the largest and most profitable equity capital market in the GCC.[335]As of 2012, the MSCI Index still classifies Tadawul as a 'standalone' market

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331 Fca.org.uk (2014) *Glossary definitions*. [Online] available from: http://fshandbook.info/FS/glossaryhtml/handbook/Glossary/M?definition=G1686. [Accessed: 21 May 2014].

332 Shin, H. S. (2009) Reflections on Northern Rock: The Bank Run that Heralded the Global Financial Crisis. *Journal of Economic Perspectives*. Volume 23(1).

333 Fca.org.uk (2013) *The Code of Market Conduct (MAR 1)*. [Online] available from: http://fsandbook.info/FS/html/FCA/MAR/1. [Accessed: 20 April 2014].

334 Casciani, D. (2012) How Asil Nadir Stole Peck's millions. *BBC News*. [Online] available from: http://www.bbc.co.uk/news/uk-19161940. [Accessed: 5 June 2014].

335 See the statistics on Tadawul, *supra* notes 56 & 57.

although expectations that this will change to frontier in the near future are high.[336] The market is characterised by robust corporate performance, high liquidity and share turnover as a result of elevated oil prices and a solid private non-oil sector. By the end of 2013 a total of 163 companies were listed on Tadawul including such heavy weights as Saudi Aramco, Saudi Telecom, Sabic and Saudi Oger and by the end of 2014 that number reached 169.[337]

KSA disclosure rules meet the international standards of the IOSCO and the Basel Committee on Banking Supervision and they are similar to the current rules of the LSE. However, when comparing KSA Listing Rules with the Listing Rules of LSE or any other developed market, it should be taken into account that the comparison is between the rules of two different types of markets; an emerging capital market that has started a few decades ago and has a different structure will have different problems than a mature open market. It can be said that KSA Listing Rules are, principally, a direct translation of the LSE Listing Rules. In order for this translation to suit the market conditions, they came with straightforward and easy language that can be understood by anyone no matter what his profession is. The straight forwardness in KSA rules might be due to the nature of investors in the market, as many investors in KSA do not rely on professional advice when making their investment decisions.[338]

Transparency and disclosure issues are closely related to MSCI's classification of Tadawul as a standalone market since it lacks clear and consistently coherent rules [339] and regulations with regard to openness to foreign ownership (current swap agreement with CMA is complicated and time consuming), foreign ownership level and foreign room level (which refers to the percentage of traded shares that can be owned by non-Saudi individuals or institutional investors) as well as ease of capital inflow and subsequent restrictions. As a result of Tadawul's isolation and the minimum role it plays on the global market place, it is rightly perceived by international investors and rating agencies as having significant transparency and disclosure issues. Oversight of Tadawul falls under the remit of the CMA, the financial regulator in the Kingdom.

Although larger by market capitalisation than any other GCC equity market it does not have the same reputation for corporate governance and transparency that the UAE has for example.[340] Granted, the CMA has passed a number of rules and regulations [341] that address

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[336] Msci.com (2014) *MSCI to Reintroduce Indices for Saudi Arabia*. April 2012. [Online] available from: http://www.msci.com/resources/pressreleases/MSCI%20Reintroduces%20Indices%20April%2030%202012%20FINAL.pdf. [Accessed: 13 May 2014].

[337] Tadawul.com.sa (2015) *Company List*. [Online] available from: http://www.tadawul.com.sa/wps/portal/!ut/p/c0/04_SB8K8xLLM9MSSzPy8xBz9CP0os3g_AewIE8TIwN_tzAnA09vQ7cwYzcDQwNnY_3g1Dz9gmxHRQDIfuKO/ [Accessed: 9 January 2015].

[338] An empirical study found that investors in Saudi Arabia security markets have limited access to professional financial analysts. See Al-Aqeel, M. & Spear N. (2006) Private Information Trading in Emerging Markets: Evidence from GCC Security Markets. In *The Institute of Public Administration*. Riyadh. 16, 29; and Baamir, A. Y. (2008) Issues of Transparency and Disclosure in the Saudi Stock Market. *Arab Law Quarterly*. Volume 22. No. 1. 63-87.

[339] See MSCI to Reintroduce Indices for Saudi Arabia, *supra* note 336.

[340] In this study it was found that UAE companies have significantly higher voluntary disclosure than Saudi companies, with an average of around 42 per cent for UAE companies and 32 per cent for Saudi companies. For more information, see Al-Janadi, Y., Rahman, R. A. & Omar, N. H. (2012) The level of voluntary disclosure

key issues such as resolution of disputes, merger and acquisition regulations, investment funds regulations, the market code of conduct and corporate governance rules, but the application and adherence to some of these rules can be tenuous at times.

A key issue highlighted by the IMF relates to the lack of clarity and transparency surrounding the CMA's role relating to corporate governance and duties of directors of listed entities.[342] For example, board sanctions of CMA Authorised Persons (AP's) are sometimes not published, in which case, board member names of certain listed entities (who have transgressed CGRs) are not publicly named, thus hampering the disclosure and transparency of the market and negatively impacting investor confidence. It should be taken into account that in KSA, political and social etiquette might be a factor when dealing with the Kingdoms' business affairs in which matters of transparency and disclosure play a less prominent role in the capital markets. Disclosure and transparency in enforcement also appear to be an issue.[343] Enforcement penalties are not exercised equally across all the listed entities on Tadawul with the result that the CMA has been unable to demonstrate a balanced, consistent and equitable track record in its regulatory actions.[344]

A potentially greater problem is posed by the approval and disclosure of related party transactions, especially those occurring between employees (and their families) of the listed entity and other third parties. KSA companies are required by law to disclose to the CMA any transactions between the company and connected persons and to publish such information. It would seem that the system currently in place governing the review, approval and disclosure of related party transactions requires further development and execution.[345]

In addition, KSA, unlike the UK, suffers from a weak secondary market which is a reflection of a narrow investor base, a short-term investment culture and the absence of investment banks and large foreign institutional investors. Due to a lack of a liquid secondary

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practices among public listed companies in Saudi Arabia and the UAE: Using a modified voluntary disclosure index. *International Journal of Disclosure and Governance*. Volume 9. Issue 2. 181-201; and Grant Thornton International Ltd. (2008) *Middle East: Towards Innovation and Transparency: Capital Markets Guide 2008*. [Online] available from: http://www.gtkuwait.com/pdf/memg_report_final.pdf, 8 and 9. [Accessed: 16 July 2014].

[341] Cma.org.sa (2013) *Implementing Regulations*, *supra* note 202.

[342] Imf.org (2012) *Saudi Arabia: Reports on the observance of standards and codes (ROSC)*. IMF Country Report No. 12/93.April 2012. [Online] available from: http://www.imf.org/external/pubs/ft/scr/2012/cr1293.pdf. 19 [Accessed: 7 June 2014].

[343] A former legal advisor to the CMA claims that despite the fact that disclosure rules are in place, in practice they are not very functional. Al-Nasiri, I. (2012) Law and Transparency O CMA. *Alsharq*. 11 April 2012. [Online] available from: http://www.alsharq.net.sa/2012/04/11/212941. [Arabic]. [Accessed: 13 January 2015].

[344] The IMF (2012) *'Saudi Arabia: Reports on the observance of standards and codes*,'*supra* note 342 at 11; and Alanazi (2012) *'Investor Protection and the Civil Liability…'*, *supra* note 5, at 355, in which the following was stated: "… the exercise of power by the CMA needs to be balanced. In a number of instances …, the exercise of the regulator's power has been described as lenient in regard to the level of investigation and also in the subsequent imposition of sanctions for wrongdoing related to matters of disclosure. Hence, it can also be argued that the CMA is, like other institutions, affected by a tendency to 'underestimate the likelihood of fraud [or other illegal activities] during booms and overestimate it following busts,' and thus following a 'crash' might be expected to be overly harsh or disproportionate in its actions against companies."

[345] Worldbank.org (2009) *Saudi Arabia: Corporate Governance Country Assessment. Report on the Observance of Standards and Codes (ROSC).* February 2009. [Online] available from: http://www.worldbank.org/ifa/rosc_cg_saudia_arabia.pdf. [Accessed: 5 September 2014].

market, portfolio and fund managers are also reluctant to invest. The market also lacks fixed income institutional investors and investment funds that usually play an important role in secondary market trading. We take note that the growth in KSA's primary market size is not a direct reflection of a liquid secondary market but has to do with the availability of adequate captive sources of funds already available in the country primarily as a result of oil industry returns.[346]

In a similar vein to KSA, the UAE suffers from the same deficiencies related to the transparency and disclosure. The regulation of timely disclosure in local financial markets in the UAE consists of three articles under the SCA regulations as to Disclosure and Transparency.[347] It should be noted, that discussing the problems of disclosure in more detail revealed that there are shortcomings in the regulations, and that the related articles are poorly drafted, as there are issues related to clarity of those articles that gives room to interpretation and creates difficulty in implementation.[348] It is unclear when the effect of "any significant developments affecting the prices of such securities" that would trigger the disclosure by the issuer be 'probable' or 'definite.' Another shortcoming is that the time in which disclosure should be made is not indicated, as stating that "upon learning of the same" is not clearly determining the reasonable time in which disclosure is required. Moreover, not only that there is no mention of the issuer's liability in relation to "selective disclosure," but there is no clear obligation to protect the information from being used by employees, or from being disclosed to a third party other than relatives to the first degree. Therefore, the above shortfalls indicate that inside information is not sufficiently protected by the SCA regulations.[349]

Hence, despite that UAE has more liberal economy than KSA but the same shortcomings of KSA market also exist in the UAE such as weakness of transparency and market infrastructure. It was noted that the lack of predictable immediacy, is a major weakness in the MENA market. If for example, there is an imbalance between buy and sell orders during a trading period, successive buy (sell) orders would get noted on the trading board without counter sell (buy) orders arriving at the market. Indeed, such imbalances would cause prices to move up or down in a volatile manner.[350]

The previous shortcomings encouraged market manipulation, which was one of the main reasons behind the collapse of February 2006. At that event, large speculators took advantage of having naive retail investors who traded in speculative shares as well as

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[346] For more details, see Akoum, I. (2009) Privatization in Saudi Arabia: Is slow beautiful?. *Thunderbird International Business Review*. 51(5). 427-440; Ben Naceur, S. & Ghazouani, S. (2007) Stock markets, banks, and economic growth: Empirical evidence from the MENA region. *Research in International Business and Finance*. Volume 21. Issue 2. 297–315. 297–315; and Ben Naceur, S., Ghazouani S. & Omran M. (2008) Does stock market liberalization spur financial and economic development in the MENA region?. *Journal of Comparative Economics*. Volume 36. Issue 4. 673–693.
[347] The SCA Regulations as to Disclosure and Transparency, *supra* note 275.
[348] Albelooshi (2008) *'The Regulation of Insider Dealing…,' supra* note 251, at 88-90.
[349] *Ibid*, 89.
[350] Oecd.org (2005) *Ownership structures in MENA countries: listed companies, state-owned, family enterprises and some policy implications*. [Online] available from: http://www.oecd.org/dataoecd/26/2/ 35402110.pdf. [Accessed: 18 September 2014].

inexperienced regulators. Another point worth mentioning is the small number of listed companies in KSA stock market and the UAE; there are 169 listed companies in the former market while there are 121 in the latter markets,[351] compared with the average of 300 to 350 companies in a normal emerging market. Adding the ownership structure to the latter point resulted in an excessively high proportion of the total trading volume in the secondary market.

This fact (Illiquid Securities) might have some serious impacts on the behavior of stock prices (Pricing Efficiency) and suggested that the number of listed companies should be higher. As a result of this low level of liquidity, due mainly to the fact that the overwhelming majority of stocks are concentrated in the hands of the government and major business families, the stock market has so far been dominated by a small number of dealers. In addition to that, the largest 20 or so companies are not listed on the stock exchange, either because they are family owned or the government owns them.[352]

The UAE financial regulator the SCA has yet to develop an efficient secondary market for bonds, sukuk and other financial instrument including derivatives. There is currently on-going research and discussion at the financial regulator to develop a framework for the expansion of a second market. Preliminary indications suggest that regulations for the launch of a dedicated second market are forthcoming in the next year or two.[353]

On deeper examination, the lack of efficient second markets appears to be a function of government apathy as well possible opposition from powerful commercial banks. In either case, authorities have come to accept that the development of the market for government securities as well as conventional bonds is vital for the overall development of the markets. Indeed the secondary market for government securities may act as a catalyst for wider fixed income securities markets development. As secondary markets develop, transaction costs are lowered and liquidity increases, so investors gain the confidence needed to invest in long-term government securities.[354]

In comparing the level of voluntary disclosure between KSA and UAE companies, it is noted that UAE companies have significantly higher disclosure scores than those in KSA especially in the category of general and financial information. The KSA Stock Market was established in 1985 and the UAE stock markets were not fully established until 2001; thus, the KSA stock market was expected to be more stable in disclosing information than the UAE stock markets. However, KSA companies disclose less information than UAE

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[351] As per the data appears on the websites of Tadawul, as well DFM and ADX collectively on 26 September 2014, *supra* notes 337, 74, 73 respectively.

[352] McKinsey & Company (2005) *'Developing and Integrating GCC Capital Markets…,' supra* note 44, at 5, 19-20. See also Oecd.org (2005) *'Ownership structures in MENA countries…', supra* note 350.

[353] See Sca.gov.ae (2014) *H.H. Sheikh Mohammed bin Rashid launches "Second Market" of UAE financial market, gives directives for trading to start soon*. [Online] available from: http://www.sca.gov.ae/English/news/Pages/214-09-24.aspx. [Accessed: 25 September 2014]; and Sca.gov.ae (2014) *SCA holds road shows to highlight bonds and sukuk*. [Online] available from: http://www.sca.gov.ae/English/news/Pages/17-09-2014.aspx. [Accessed: 25 September 2014].

[354] See Ben Naceur (2007) *'Stock markets, banks…', supra* note 346; and Ben Naceur, et al. (2008) *'Does stock market liberalization…', supra* note 346.

companies. Thus, the authorities of the KSA stock market should issue regulations that require companies to disclose more information.[355]

However, generally, it is noted that the quality of reporting in both KSA and the UAE is at a low level. Thus, greater concern is required from both stock market authorities and companies to improve voluntary disclosure practices. In order for companies to earn the trust of investors, sufficient information is required to be provided on corporate governance practices as an acceptable control system. Disclosure of corporate governance practices is also another area that has to be improved on by companies, especially in regards to board of directors' information, board performance and ownership structure.[356]

Directors are the main key to good practices in the corporate governance system; however, the majority of the companies in both countries do not provide information on directors (qualification skills, training, and number of shares held), which reveals that companies are not concerned about the characteristics that directors should possess. However, it is important for the investors to have information on the level of qualifications and skills of the directors, and hence the selection of the directors may be affected by several factors, such as relatives as shareholders, family ownership and government ownership. These types of ownership have an interest in electing directors who represent them in the board regardless of the qualification and experience of these directors. Thus, both the companies and the authorities should improve the requirements and the attributes that directors should possess.[357]

There are several additional important areas of disclosure that companies do not pay sufficient attention to in providing information, especially the items of environmental disclosure (environmental policies, environmental performance, environmental protection and product information). Thus, companies need to formulate environmental policies. In addition, companies have to take social and environmental issues seriously and publish environmental reports.[358]

## 6.2 The Problems Related to Systemic Risk Management

A goal of financial supervision is to monitor the overall functioning of the financial system as a whole and to mitigate systemic risk. Financial systems cannot function effectively without confidence in the markets and financial institutions. A major disruption to the financial system can reduce confidence in the ability of markets to function, impair the availability of credit and equity, and adversely impact real economic activity. Liquidity is inevitably withdrawn and the fundamental mechanics of a robust market come to sudden halt.

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355 Falgi, K. (2009) Corporate Governance in Saudi Arabia: A Stakeholder Perspective. *PhD Thesis*. United Kingdom: University of Dundee.
356 Al-Janadi, et al. (2012) *'The level of voluntary disclosure practices…'*, *supra* note 340, at 198.
357 *Ibid*., 194. See also Robertson, C. J., Diyab, A. A. & Al-Kahtani, A. (2013) A cross-national analysis of perceptions of corporate governance principles. *International Business Review*. Volume 22. Issue 1. 315-325.
358 *Ibid*.

Systemic risk generally refers to impairment of the overall functioning of the financial system caused by the breakdown of one or more of the key market components.[359] Systemically important players would include, among others, large multinational banks, hedge funds, securities firms, and insurance companies. In addition, there are systemically important markets and infrastructures, in particular, the payments and clearance and settlement systems.[360] The clearing systems used today, post financial crisis, are far more structured and regulated than they were pre-meltdown.

The 2008 financial crisis was a historical watershed event. It redefined the meaning of systemic risk and how to mitigate such risks. Other than Black Monday on October 19th 1987 in which the LSE shed 29% in a few days, the UK equity capital markets had never witnessed such a severe paralysis of the financial and banking markets before. What went wrong?. Was this crisis caused by financial institution collapse or was this the result of an overall market failure?. Questions remain of course but most prevailing attitudes point out to the collapse of the mortgage market as the preliminary cause of the global financial crisis. The Lehman Brothers collapse was triggered by the implosion of the market for mortgage-backed securities (asset backed securities) and collaterised debt obligations. Events were felt worldwide instantly.[361]

In the UK, Northern Rock was the first victim of the financial tsunami, credit dried up overnight, money markets shut down, depositors ran on the banks, home prices stopped appreciating and borrowers (who had borrowed on the estimated and over inflated value of their homes prior to the crisis) defaulted on their loan and regulators over the world were shocked and shaken into action. The defaults caused by investors eventually led to an overall downgrading by global credit agencies of the institutions that held them on their books. The results were catastrophic. No one wanted to buy these securities anymore. Credit rating agencies that had hitherto rated institutions and transaction as "AAA" were now reversing their decision. Major firms were left holding worthless securities which had lost more than half their value. Defaults followed defaults. Firms collapsed. Jobs were lost.[362] In the UK, the City of London witnessed slow death spirals as financial institutions had to write down losses

[359] According to 2001 report on the Consolidation in the Financial Sector, the Group of Ten (2001) defines systemic risk as follows: Systemic financial risk is the risk that an event will trigger a loss of economic value or confidence in, and attendant increases in uncertainty about a substantial portion of the financial system that is serious enough to quite probably have significant adverse effects on the real economy. Systemic risk events can be sudden and unexpected, or the likelihood of their occurrence can build up through time in the absence of appropriate policy responses. The adverse real economic effects from systemic problems are generally seen as arising from disruptions to the payment system, to credit flows, and from the destruction of asset values. For more information, see Wewel, C. N. (2014) Essays on Systemic Risk and Stock Market Contagion. *PhD Thesis*. Germany: Universitätzu Köln. (English); and Trapp, M. & Wewel, C. (2013) Transatlantic systemic risk. *Journal of Banking & Finance*. Volume 37 (11). 4241–4255.

[360] Kaufman, G. & Scott, K. E. (2003) What Is Systemic Risk, and Do Bank Regulators Retard or Contribute to It?. *The Independent Review*. VII. No. 3. 371– 391.

[361] Schwarz, S. L. (2008) Protecting Financial Markets: Lessons from the Subprime Mortgage Meltdown. *Minnesota Law Review*. Volume 93 (2). [Online] available from: http://scholarship.law.duke.edu/cgi/viewcontent.cgi?article=2614&context=faculty_scholarship. [Accessed: 8 May 2014].

[362] *Ibid*. See also Oecd.org (2012) *OECD Reviews of Risk Management Policies, Systemic Financial Risk*. [Online] available from: http://dx.doi.org/10.1787/9789264167711-en. [Accessed: 2 October 2014].

in billions as a result of the rules that require companies to account for shares on a mark-to-market basis.[363] Further panic ensued.

One of the clear lessons from the financial crisis was the lack of an adequate legal framework for crisis management of failing financial institutions in the UK.[364] While the Bank of England was able to respond to market-wide demand for extra liquidity, the possibility of intervention in individual institutions by the regulatory authorities was limited by a lack of formal powers enabling them to take control of failing institutions. Meanwhile, the option of permitting insolvency was complicated by the absence of a special insolvency regime for banks, which meant that customer deposits and other claims could be frozen for a long period of time pending the working out of the insolvency procedure. Thus, it became clear over time that limited crisis management options were themselves a causal factor in determining the consequences of the crisis.[365]

Massive government bailouts had to be organised and negotiated both in the US and Europe.[366] Worldwide, governments and regulators over the world began to take steps to address the failure in systemic risk procedures that allowed so many institutions to collapse like a house of cards. The primary focus of securities regulators traditionally has been on customer protection, with the safety and soundness of the institution being one means of furthering that goal. Safety and soundness regulation involves a mixture of conservative rules and more prudential review and appraisal, with an emphasis on persuasion rather than through enforcement action involving fines, penalties, or other sanctions. Laws and regulations were passed including the US Dodd-Frank Act of 2010 [367] and the UK Financial Services Act.[368] Matters related to disclosure of counterparty exposure were addressed. Today, as per the FCA, firms transacting over and above certain daily thresholds in the

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[363] A measure of the fair value of accounts that can change over time, such as assets and liabilities. Mark to market aims to provide a realistic appraisal of an institution's or company's current financial situation. Or the accounting act of recording the price or value of a security, portfolio or account to reflect its current market value rather than its book value. See Investopedia.com (2014) *Definition of 'Mark To Market - MTM'.* [Online] available from: http://www.investopedia.com/terms/m/marktomarket.asp?layout=orig. [Accessed: 4 July 2014].

[364] This defect was common to many systems: see, e.g., University of Glasgow (2010) *The Trajectory of Regulatory Reform in the UK in the Wake if the Financial Crisis*. Basel Committee on Banking Supervision. Consultative Document. Report and Recommendations of the Cross-border Bank Resolution Group (September 2009). [Online] available from: http://www.asbaweb.org/Consulta-Reporte.pdf. [Accessed: 28 September 2014].

[365] MacNeil (2010) *'The Trajectory of Regulatory Reform in the UK…'* , *supra* note 176, at 495-96.

[366] Without government intervention and actual outright purchase of institutional shares many of the world's largest banking institutions would have gone under including Citibank, Barclays, Royal Bank of Scotland, Bank of America (BOA), Standard Chartered, J.P. Morgan as well as some of the larger investment banks including Goldman Saks and Merrill Lynch. Merrill Lynch, which eventually would be purchased by BOA as a result of losses worth US$8.4 billion, has never quite regained its former reputation. Keoun B. (2007) Merrill Lynch Reports Loss on US$8.4 Billion Writedown. *Bloomberg.* [Online] available from: http://www.bloomberg.com /apps/news?pid=newsarchive&sid=axuWCcMY MdA0. [Accessed: 4 July 2014].

[367] Sec.gov (2013) *Dodd-Frank Wall Street Reform and Consumer Protection Act*. January 2010. [Online] available from: http://www.sec.gov/about/laws/wallstreetreform-cpa.pdf. [Accessed: 28 August 2013].

[368] Legislation.gov.uk (2010) *Financial Services Act 2010*. [Online] available from: http://www.legislation.gov. uk/ukpga/2010/28/contents. [Accessed: 6 May 2014].

derivatives and futures markets are obligated to inform the FCA.[369] Obligatory requirements, with the emphasis on obligatory, have become the norm rather than the exception.

Unlike Europe and the US, KSA came through the financial crisis relatively unscathed.[370] KSA banking and securities market sectors are generally well capitalised and insulated and has withstood any temporary shocks to date. Saudi investors and financial institutions also had minimum exposure to collateralised debt obligations and so emerged from the crisis in robust shape. SAMA, the KSA's Central Bank, is hugely funded and cash reserves[371] are more than sufficient to ensure long term financial stability. The direct effects of the crisis were felt in KSA through tighter global financing conditions and weaker investor confidence, putting downward pressure on local equity markets.[372] The indirect impact was transmitted through a sharp reduction in oil prices in 2009 (36 percent) and cuts in oil production (8.7 percent).[373]

As a result the crisis also had only a modest impact on KSA financial system. At the onset of the crisis, banks' exposure to mortgage backed securities and other securitised assets amounted to only 3 percent of total assets.[374] Nonetheless, global liquidity shortages did transmit to KSA interbank market, causing the spread between KSA interbank offered rate and the reverse repo rate to increase to over 200 basis points in October 2008. However, swift action by SAMA soon restored confidence in the market.[375]

The main impact on the financial system came through the banking sector's exposure to the defaults of two family conglomerates. Although the banks absorbed these losses, the two families in question, a Saudi holding company owned by the Al-Gosaibi family had defaulted on foreign exchange transactions, trade finance loans and swap agreements amounting to US$1 billion.[376] The other, Sa'ad Al Sanea,[377] is one of the world's richest men

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[369] Fca.org.uk (2014) *BIPRU Handbook11.3*. Information to be disclosed and frequency. [Online] available from: http://fshandbook.info/FS/html/FCA/BIPRU/11/3. [Accessed: 11 July 2014]. Notably, the FSA (now the FCA) has drawn up 39 lessons it had learnt from the Northern Rock episode. The seven high level recommendations include improvements to the rigour of day-to-day supervision; senior management to increase engagement with high-impact firms; increase its focus on prudential supervision (including liquidity and stress testing); improve resources; improve the quality and resources of its financial and sectoral analysis; strengthen supervisory resources and senior managers should increase their oversight of supervision.Fsa.org.uk (2008) *The supervision of Northern Rock: A lessons learned review report*. FSA Internal Audit Division. March 2008. [Online] available from: http://www.fsa.gov.uk/pubs/other/nr_report.pdf. [Accessed: 30 December 2015].

[370] Alanazi (2012*) 'Investor Protection and the Civil Liability…', supra* note 5.

[371] Imf.org (2013) *Saudi Arabia: Selected Issues*. IMF Country Report No. 13/230. 24 June 2013. [Online] available from: http://www.imf.org/external/pubs/ft/scr/2013/cr13230.pdf. [Accessed: 13 May 2014].

[372] See Alhilali, M. (2011) Analysts: Capital Market Authority Is in Need of Reforms. *Aleqtisadiah*. 3 December 2011. [Online] available from: http://www.aleqt.com/2011/12/03/article_603590.html [Arabic]. [Accessed: 16 August 2014]; and Al-Abdulkarim, F. (2010) Investors Flee Following the February Collapse Creates Crisis of Confidence and Weakness in the Saudi Market. *Alriyadh*. 4 August 2010. [Online] available from: http://www.alriyadh.com/2010/08/04/article549163.html. [Arabic]. [Accessed: 16 August 2014]. See also Imf.org (2012) *Saudi Arabia: Financial System Stability Assessment—Update*, *supra* note 194.

[373] Imf.org (2012) *Saudi Arabia: Financial System Stability Assessment—Update*, *ibid*., at 9.

[374] *Ibid*., 9.

[375]*Ibid*.

[376] Economist.com (2015) The Algosaibi affair: A Saudi saga. *The Economist*. 21 March 2015. [Online] available from: http://www.economist.com/news/business/21646751-six-years-claims-arising-huge-corporate-scandal-gulf-are-still-being. [Accessed: 10 October 2015].

whose company (unlisted) had assets of US$30 billion including over US$7 billion in cash which were eventually frozen by SAMA.This was followed a few days later by a downgrade in the company's investment grade rating by credit ratings' agency Standard and Poor's (S&P), before being withdrawn completely, in response to news that Sa'ad Group's management was suspending debt service payments in agreement with its creditors. Banks in KSA suffered significant balance sheet impairment and the events highlighted the urgent need for KSA to improve the transparency and disclosure in conglomerates as well as stricter guidelines for auditors.

In the UAE, the financial crisis had a clearly negative impact. Unlike KSA, whose market is closed to the outside world, the UAE's equity capital markets as well as banking system is relatively open to the influences of the external world.[378] Throughout 2003 – 2008, the oil bomb in the UAE and the increased price of a barrel led to large fiscal surpluses. Abundant liquidity in the UAE fueled credit growth with banks' lending vast sums of money to institutions and individuals. In the UAE, credit growth went largely into construction and real estate lending, fueling a real estate boom with a subsequent stock market gain of 22-60% in 2007.[379]

Inflation took off and asset prices escalated as a result.[380] Corporates became highly leveraged and an asset bubble developed around real estate and share prices. The end was inevitable. The boom came to an abrupt end in late 2008. De-leveraging took place on a large scale, oil prices fell, the UAE's external and fiscal surpluses declined markedly, stock and real estate prices plunged, credit default swaps spreads on UAE sovereign debt widened and the liquidity dried up overnight. Moreover, Dubai's two-largest mortgage lenders that were listed on DFM were suspended from trading.[381]

Decisive action by the CBUAE, the Ministry of Finance, the SCA and other responsible bodies helped to moderate the crisis. Infusion of liquidity into the markets by the deposit of long term government funds at banks, re-capitalisation of UAE banks and the

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377 Uppal, R. (2009) Fear of default rocks Saudi corporates. *Gulf news*. 10th July. [Online] available from: http://gulfnews.com/business/sectors/banking/fear-of-default-rocks-saudi-corporates-1.500823. [Accessed: 2 January 2015].

378 Kumah, F. Y. et al. (2010) Impact of the global financial crisis on the Gulf Cooperation Council countries and challenges ahead. *International Monetary Fund*. Middle East and Central Asia Department, Washington D.C.3; and Imf.org (2011) *United Arab Emirates Selected Issues and Statistical*. IMF Country Report No. 11/112. May 2011. [Online] available from: http://www.imf.org/external/pubs/ft/scr/2011/cr11112.pdf. [Accessed: 12 January 2015]. Notably, the influence of Islam on the Saudi Arabian cultural traditions has been very powerful. This is a common thread throughout the Middle East. There are four unique influences on Arab values: foreign rule, the Western quest for oil, Bedouin/tribal traditions, and Islam. The scope and magnitude of influence of each factor tends to vary from country to country and it is this variation that creates cultural, ethical and behavioral differences across the region. The variation in these factors also determines the extent to which each nation is more or less open to convergence, divergence, or crossvergence. See Hickson, D. & Pugh, D. (1995) *Management worldwide: the impact of societal culture on organizations around the globe*. London: Penguin Books; and Robertson et al. (2013) *'A cross-national analysis…'*, *supra* note 357.

379 Imf.org (2013) '*United Arab Emirates: Selected issues'*, *supra* note 303 at 6.

380 *Ibid*.

381 Bloomberg (2014) *U.A.E. Takes Over Mortgage Lenders Amlak*, *Tamweel*. [Online] available from: http://www.bloomberg.com/apps/news?pid=newsarchive&sid=ayg4qgY5.VQc. [Accessed: 26 September 2014].

tightening of lending rules to the real estate and construction sectors occurred almost overnight. The financial crisis led to the SCA reviewing its licensing rules for brokerage houses with the subsequent shutting down of over 50 brokerage houses over a 2 year period after the onslaught of the financial crisis.

In fact, the severity of the threat to the UAE's systemic risk system prompted the UAE Authorities to consider a Twin Peaks approach to financial regulation, similar to that approach used by the Netherlands and Australia. The Benefits of the Twin Peaks system are well documented and will primarily allow the regulation of the UAE's capital market via a bi-pronged approach whereby conduct of business regulations will primarily be the domain of the SCA and systemic risk the remit of the CBUAE. Notably, that the UAE has not, as of yet, adopted this approach to financial regulation even though discussions and research on the topic have been extensive.

### 6.3 The Problems Related to the Shortage of Institutional Investors within the Markets and the Investor Confidence

Clearly, the UK equity markets do not suffer from any lack of institutional investors and London has been a major financial hub and center of finance for well over one hundred years whereas KSA market has traditionally been dominated by small retail investors. In 2010, retail investors accounted for 88% of transactions on Tadawul[382] vis-à-vis market such as London and New York where institutional investors account for approximately 90% of transactions.[383] The long-standing dominance of retail investors has led to considerable volatility over the years. Large institutional investors who were traditionally not permitted (although this has changed to a degree) and acted as long term anchors in other markets could not provide stability to Tadawul. The key to deepening KSA markets was increasing institutional participation, particularly from foreign entities who have the potential to reduce volatility by buying when valuations make sense.[384] Foreign entities also promote more rigorous scrutiny of markets, hence their participation would certainly add to the overall transparency. As of 2005, SAMA had awarded several investment banking licenses to foreign banks who were also permitted to provide brokerage service. Although many of these banks provided research, it is debatable to what extent local KSA investors took advantage of such research to help them in making informed investment decisions.[385]

The UAE also has traditionally been dominated by small retail investors. The long-standing dominance of retail investors has led to considerable volatility over the years

[382] Samba.com (2009) *The Saudi Stock Market: Structural Issues, Recent Performance and Outlook*. December 2009. [Online] available from: https://www.samba.com/GblDocs/Saudi_Stock_Market_Eng.pdf. [Accessed: 6 March 2014].
[383] Ramady (2010) *The Saudi Arabian Economy: Policies, Achievements and Challenges*, *supra* note 211, at 167.
[384] Law, M. K. H. (2011) Behavioural Risk Disclosure and Retail Investor Protection: Reflections on the Lehman Brothers Minibonds Crisis. *Hong Kong Law Journal*. Volume 40(1). 15, 39; and Albalawi, A. (2012) Shura Criticises the Capital Market Authority. *Alriyadh*. 5 November 2012. [Online] available from: http://www.alriyadh.com/2012/11/05/ article781714.html. [Arabic]. [Accessed: 6 March 2014].
[385] Alanazi (2012) *'Investor Protection and the Civil Liability…'*, *supra* note 5, at 364.

leading to a herd mentality[386] of investing and divesting as well as an erroneous investor perception that the market as a one way gamble with a guaranteed pay-off. International institutional investors represent a small amount of daily, monthly and yearly volume on the DFM and the ADX. Institutional investors represent about 22% of average monthly value of stocks traded. For example, in September 2013,[387] DFM released its monthly trading statistics which revealed that of the total of 21 billion Dirhams value of shares bought by both institutions and individuals, 4.5 billion Dirhams[388] or approximately 22% was purchased by institutions. Clearly, 'institutions' have room and financial ability to purchase a great deal more than 'individuals' so the disparity between the two reveals the lack of institutional investors in the market.

As previously indicated, the benefits of having a deeper market for institutional investors also promotes more rigorous scrutiny of markets, hence their participation would certainly add to the overall transparency. It is no secret that the UAE's capital markets scene needs to attract more institutional investors to ensure long-term growth prospects. Retail investors continue to dominate the bulk of trading activity and the authorities believe more investment is required from overseas to ensure healthy returns and long-term prosperity. To ensure this happens, authorities believe that investor education is vital towards increasing investors.

Additionally, not only London is one of the world premier listing destinations due to its deep liquid pools of cash, large and sophisticated institutional investors as well as a trustworthy and proven financial system policed by a world class regulator, but it's reputation speaks volumes for itself and there is no lack or shortage of investor confidence. However, the aftermath of the financial crisis in the UK did cause the regulators and financial bodies to question the logic and structure of their regulatory system.[389] Investor confidence may well have been temporarily dented, especially as a result of the bail-out of Northern Rock, Barclays Bank and the Royal Bank of Scotland but it was not sufficient for investors to flee in masse from the market without ever wanting to return. Juxtaposed to this is investor perception and confidence in other less well developed markets including KSA and the UAE.

Problems of disclosure and the quality of assets are the backbone of the regulation of securities markets. The lack of incentive for management and issuers to provide the information needed to assess the quality of the assets may render price discovery in the markets unreliable. The rationale for having regulations is to protect investors from questionable practices and opportunistic behaviour by market participants whose activity

[386] The herd mentality can be defined as people's tendency to make decisions based on the actions and opinions of others and simply follow the herd. For more information see Ghoul, W. A. (2013) Herd Mentality, the Good, the Bad, and the Ugly!. *Cultural Studies*. Volume 24. Issue 3; and Orrman-Rossiter, S., & Orrman-Rossiter, K. (2009). Herd mentality. *Intheblack*. 79(2). 32-35.

[387] Dfm.ae (2013) *DFM Performance September 2013*. [Online] available from: http://www.dfm.ae/Documents/IR/DFM%20Performance%20September%202013.pdf. [Accessed: 15 January 2014].

[388] *Ibid*.

[389] The recent crisis has exposed a number of problem areas and deficiencies in the UK financial sector safety net. For more details, see Campbell A. & Lastra R. (2010) Revisiting the Lender of Last Resort – The Role of the Bank of England. In: MacNeil and O'Brien (eds.). *The Future of Financial Regulation*. United Kingdom: Hart Publishing. 161-178.

may undermine the integrity of the markets and as well as erode investor confidence in them.Accordingly, it is worthwhile for policymakers to introduce regulations that reduce informational disadvantages and maintain investor confidence. It follows that securities markets regulations could be categorised as regulations that aim to increase disclosure and to protect investors from malpractice. Regardless of what good regulations are introduced or what they aim to achieve, they are in themselves without any practical benefits. Regulations without enforcement are worthless.[390]

In light of this statement, a shortage of investor confidence in a financial regime is usually an indication of several factors, primarily that of a lack of trust in the underlying mechanics of the market. Lack of confidence denotes that the rules do not work very well. That is why it is imperative that the CMA adopts clear policies that are enforceable. Of equal importance, investors need to be able to see such enforcement taking place, hence the importance of disclosure and transparency by a financial regulator. The issue of disclosure and transparency in KSA is not new and the authorities are aware that they need to address this.[391]

The primary responsibility of financial regulators is to ensure, amongst other things, that investor confidence remains high. There is no point in having detailed financial regulations and no investors. Lack of investor confidence can be a function of several factors. For example, restoring investor confidence in the local audit process as well as improving the reliability of audited financials issued by issuers would be integral towards maintaining investor confidence. Transparency of disclosure is a non-negotiable requirement of an effective and efficient market regulator. As of March 2014, 97.5% [392] of the listed entities in the UAE issued their audited financials as per IFRS and on time as per the requirements of the SCA. Adherence to these standards is expected to boost investor confidence no doubt.

In difference to KSA's CMA, the SCA does not publish its audited financials neither does it issue reports to the market in a comprehensive manner that outlines all the changes or proposed changes taking place in the UAE equity markets. By following KSA, the SCA would certainly be taking the step in the right directions towards transparency and regulatory disclosure. Why, one might ask, should the rules of disclosure apply to listed entities only? Shouldn't the rules of disclosure also apply to the SCA? Who regulates the regulator?

Furthermore, the CMA in KSA publishes relatively all names and penalties of violators of securities regulations in order to ensure investors that perpetrators are indeed being reprimanded. Once again and at odds with most sophisticated markets, the UAE sets no such precedence. The SCA regulated firms that are in breach of regulations may be

[390] See Johnson S. (2002) Coase and the Reforms of Securities Markets. *International Economic Journal.* Volume 16. Issue 1. 1-19; La Porta, R., Lopez-De-Silanes, F. & Shleifer, A. (2006) What Works in Securities Laws. *Journal of Finance*. Volume 61. Issue 1. 1-32; La Porta, R. et al. (2000) Investor Protection and Corporate Governance. *Journal of Financial Economics*. Volume 58. Issue 1/2. 3-27; and La Porta, R. et al. (1997) Legal Determinants of External Finance. *Journal of Finance*. Volume 52 (3). 1131-1150.

[391] Colombo, R. J. (2010) Trust and the Reform of Securities Regulation. *Delaware Journal of Corporate Law*. Volume 35. No. (3). 829-30.

[392] Sca.gov.ae (2014) *ADX Achieves 99% in Disclosure Compliance*. [Online] available from: http://www.sca.gov.ae/English/news/Pages/2014-05-20.aspx. [Accessed: 29 May 2014].

reprimanded as per the law but the imposition of such penalties is not placed in any public forum or newspaper or any other media outlet.

### 6.4 The Problems Related to Insider Dealing

The extent to which the UK government has been struggling to introduce a thorough regime of market abuse containing insider dealing offences is surprising. The resulting confusion may be explained by the fact that the UK government did not compromise by abolishing criminal sanctions under CJA 1993.[393] Retaining the criminal sanctions is probably an indication that the UK government considers insider dealing as a public wrong and there should be criminal sanctions against individuals who engage in insider dealing. It is also true that the UK government in retaining criminal sanctions intended to dedicate them to serious offences where administrative penalties do not seem to be deterrent. This is obvious in one of the following cases, which will be discussed shortly.

In 1980, the Companies Act 1980 [394] made insider dealing a criminal offense for the first time.[395] The Company Securities (Insider Dealing) Act 1985 [396] re-enacted the insider dealing provisions of the Companies Act 1980. The Financial Services Act 1986 amended the 1985 Act and also created new powers to investigate and enforce insider dealing laws.[397] The FSA gained criminal prosecution powers in 2001, although the first successful prosecution was not secured until 2009.[398]

The FCA defines "inside information" in the FSMA 2000 as information that is not "generally available" and "relates directly or indirectly to one or more issuers…and would, if generally available, be likely have a significant effect on the price of the qualifying investment or on the price of the related investments."[399] Inside information is therefore hard to come by, and knowledge of inside information places an individual or a firm at a distinct advantage over others when trading stocks. An insider is defined, as per the above Act, as a person who possesses inside information as a "result of having access to certain

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[393] Legislation.gov.uk (2012) *The Criminal Justice Act 1953, Section 52, The Offence*. [Online] available from: http://www.legislation.gov.uk/ukpga/1993/36/section/52. [Accessed: 13 August 2012].
[394] The UK Companies Act 1980, Chapter 22.
[395] See Rider, B., Alexander, K. & Linklater, L. (2009) *Market Abuse and Insider Dealing*. 2nd Ed. United Kingdom: Tottel Publishing; and Spitz, M.A. (1989) Recent Developments in Insider Trading Laws and Problems of Enforcement in Great Britain. *Boston College International and Comparative Law Review*. Volume 12. Issue 1. [Online] available from: http://lawdigitalcommons.bc.edu/cgi/viewcontent.cgi?article=1381&context=iclr. [Accessed: 15 October 2014].
[396] Company Securities (Insider Dealing Act) 1985.
[397] The Financial Services Act 1986.
[398] Enforcement proceedings in the US have also become more frequent, notably with the recent prosecutions connected with the disgraced hedge fund manager Raj Rajaratnam but there has been little enforcement activity in other EU member states against fraudulent officers and advisers, and the few prosecutions have mostly been directed against corporate executives rather than financial professionals. See The Economist (2013) *Ship of Knaves*. 1st June 2013. [Online] available from: http://www.economist.com/news/books-and-arts/21578633-rajat-gupta-had-everything-why-did-he-blow-it-ship-knaves. [Accessed: 4 May 2014].
[399] Fsa.gov.uk (2014) *Glossary – I*. [Online] available from: http://fshandbook.info/FS/html/handbook/Glossary/I. [Accessed: 4 September 2014].

information."[400] Access to the information is of course not criminal. It is the intent of the insider in the manner in which the said information will be used that matters. Armed with these definitions then, insider dealing as an offense is described in Section 52 of the CJA 1993 as:

> "An individual who has information as an insider is also guilty of insider dealing if (a) he encourages another person to deal in securities that are price-affected securities in relation to the information, knowing or having reasonable cause to believe that the dealing would take place in the circumstances mentioned and (b) he discloses the information, otherwise than in the proper performance of the functions of his employment, office or profession, to another person."[401]

The definition also includes information that is not generally available to the public and is of the kind that, if it were generally available, a reasonable person would expect it to have a significant impact upon the price or value of a company's securities or its financial instruments. Hence, a regular user would be likely to consider such information to be important in determining whether to sell, hold or buy a company's securities or other financial instruments.[402]

Traders who operate out of brokerage houses are extremely susceptible to insider dealing. The rules governing the conduct of traders in the City is therefore very strict and the implications of a trader being caught dealing with insider information are very serious indeed. In London, several prominent and recent cases have been exposed over the last few years and are punishable by hefty fines or up to seven years imprisonment. For example, in 2010, an ex-hedge fund trader with a UK trading firm called AKO Capital LLP used his position as a trader to deal in 19 different securities. He was accused of conspiring with another person based on inside information he provided on those 19 securities.[403] These dealing were to amass the hedge fund manager a sum of UK£131,000. By using his position as a trader at AKO to direct trades and commissions towards another associate who worked as a "cash equities broker," the defendant amassed a large amount of money and gifts. The amount paid to the hedge fund manager was proportionately equal to the amount of commission earned by his associate for trades placed. The exchange of information between parties is vital for there to be insider dealing. The perpetrator was sentenced to 10 months in prison as well as fined UK£50,000 for conspiracy to commit insider dealing.[404]

However there are some acts that could be misinterpreted as an insider dealings while they fall under different wrongful act. Some of the larger financial fiasco's committed in

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[400] *Ibid*.
[401] The Criminal Justice Act 1953. Section 52. The Offence, *supra* note 393.
[402] Generally, see Rider, et al (2009) *Market Abuse and Insider Dealing*, *supra* note 395; Avgouleas, (2005) *'The Mechanics and Regulation of Market Abuse…'*, *supra* note 98; and Clarke, S. (2013) *Insider Dealing: Law and Practice*. United Kingdom: Oxford University Press.
[403] Fsa.gov.uk (2010) *Ex-hedge fund trader sentenced for insider trading*. [Online] available from: http://www.fsa.gov.uk/library/communication/pr/2010/104.shtml. [Accessed: 20 July 2014].
[404] *Ibid*.

recent times by such famous traders such as Nick Leeson of Barings,[405] Jerome Kerviel of Societe Generale [406] and Kweku Adoboli of UBS [407] dealt in tens of billions of dollars but were not strictly speaking insider dealing. These traders all lost vast sums of money for their financial institutions primarily by placing wrong bets, misreading the arbitrage markets and by deliberately hiding losses from their superiors. Their conduct was certainly criminal but cannot be defined as insider dealing in its purest form.

The FCA's largest and most complex insider dealing case to date related to the arrest and subsequent conviction in 2012 of four individuals in what the FCA called "Operation Tabernula" [408] a long-running joint investigation between then the FSA and the Serious Organised Crime Agency (SOCA).[409] Another equally prominent and longest case that the FCA has highlighted is "Operation Saturn." It was a sophisticated and complex scheme that took four years to conclude.[410]

The exploitation of confidential price-sensitive information otherwise called insider dealing is the most common form of market abuse and carries severe consequences if the perpetrators are apprehended. The market for corporate securities has been vulnerable to fraud and abuse from its inception. Maintaining and upholding fiduciary trust is integral to the overall success of markets. It is also vital for positive investor perception. A market which is subject to securities fraud without due punishment or retribution will quickly lose its reputation. It is in the interests of all parties involved in the value chain to ensure that securities fraud has correct mechanisms to identify, prevent and swiftly punish it in the event it takes place. Insider dealing is also referred to as a type of securities fraud. To ensure that trust remains a key component of a market, the breach of this trust must carry serious consequences. In other words, the punishment must fit the crime. To ensure an orderly market with minimum cases of securities fraud and insider dealing then the regulator must

[405] Darroch, V. (2002) How could it happen again?; First there was Nick Leeson, now there is John Rusnak. Valerie Darroch looks at how one trader has cost Allied Irish Bank dear by losing US$750m and how, despite stringent new controls, it seems like the Barings debacle all over again. *The Sunday Herald*. February 10, 2002. [Online] available from: https://www.nexis.com/results/docview/docview.do?docLinkInd=true&risb=21_T21232396952&format=GNBFI&sort=BOOLEAN&startDocNo=1&resultsUrlKey=29_T21232396956&cisb=22_T21232396955&treeMax=true&treeWidth=0&csi=172807&docNo=25. [Accessed: 12 February 2014].

[406] Hanes, A. (2008) Suspect 'a fragile being'; Trader's best intentions can go wrong, prof says. *National Post*. January 25, 2008. [Online] available from: https://www.nexis.com/docview/getDocForCuiReq?oc=00240&lni=4RNR-7TM0-TWD3-S0WS&perma=true&csi=280434&secondRedirectIndicator=true. [Accessed: 12 February 2014].

[407] Fsa.gov.uk (2012) *FSA fines UBS £29.7 million for significant failings in not preventing large scale unauthorised trading*. [Online] available from: http://www.fsa.gov.uk/library/communication/pr/2012/105.shtml. [Accessed: 12 February 2014].

[408] For more information on the case, see Fsa.gov.uk (2012) *four charges with insider trading*. [Online] available from: http://www.fsa.gov.uk/library/communication/pr/2012/090.shtml. [Accessed: 16 June 2014].

[409] Serious Organised Crime Agency (SOCA) was closed on 7th October 2013 and replaced by The National Crime Agency (NCA). Nationalcrimeagency.gov.uk (2014) *The National Crime Agency (NCA)*. [Online] available from: http://www.nationalcrimeagency.gov.uk/. [Accessed: 11 November 2014].

[410] To uncover and investigate the criminality, the FCA obtained and reviewed over 200,000 lines of trading in 130 accounts and 375,000 lines of telephone call records. Digital forensic technology played a critical part in establishing the passage of data between the defendants. Over 300 witness statements were adduced at the trial. See Fsa.gov.uk (2013) *Enforcement Annual Performance Account 2012/13*. [Online] available from: http://www.fca.org.uk/static/documents/annual-report/fsa-enforcement-performance-account-2012-13.pdf. [Accessed: 12 February 2014].

apply strong enforcement measures that will sufficiently prevent people, firms and traders from breaking the law.[411]

As opposed to insider dealing, securities fraud is a deceptive practice in the stock or commodities markets that induces investors to make purchase or sale decisions on the basis of false information, frequently resulting in losses in violation of securities laws. More often than not, these securities are sold by "boiler rooms" or unregistered and unlicensed traders whose intent is to sell investors a non-existent or worthless stock for a financial consideration. The most common way is via telephone and this is called "cold calling" where a "trader" sells you the benefits of a share, stating that it is a good investment in return for the investor sending a cheque or divulging their credit card information over the phone. In either case, the fraudsters escape with substantial amounts of money. Investors have been conned out of their hard earned cash and have actually received nothing in return.

The UK Code of Market Conduct sets out types of conduct such as insider dealing and market manipulation that may be construed as market abuse [412] whilst the Price Stabilising Rules allow managers and their agents in financial institutions to support and correctly price the issues of securities by buying the securities in the secondary market (trading floor etc.) for a limited time after their issue. The rules relating to this provide a framework to prevent allegations of market abuse such as insider dealing and price manipulation.[413]

Market abuse and manipulation is notoriously difficult to prosecute since investigations are often extremely onerous affairs. The role an Authority plays is vital in building investor confidence; too little regulation and the market becomes unruly, too much regulation and the market stagnates. Balance must be sought and maintained. Malpractice, primarily by market members/participants is a global phenomenon. Some markets, of course, trump others in the degree of malpractice conducted whilst other have a reputation for quiet adherence to all the rules.

[411] See Black, B. S. (2000) The Core Institutions that Support Strong Securities Markets. *The Business Lawyer*. Volume 55. Issue 4. 1565; Black, B. S. (2001) The Legal and Institutional Preconditions for Strong Securities Markets. *UCLA Law Review*. Volume 48. No. 4. 781-855; Johnson S. (2002) *'Coase and the Reforms of Securities…'*, *supra* note 390, at 1, 19; and La Porta et al. (2006)*'What Works in Securities Laws'*, *supra* note 390, at 11.

[412] FCA, MAR 1, the Code of Market Conduct, page 5, Article 2, Prohibition of Market Manipulation, and page 7, Part 3, Insider Trading. See Fsa.gov.uk (2013) *Market Conduct*. [Online] available from: http://media.fshandbook.info/content/full/MAR.pdf. [Accessed: 2 September 2014].

[413] See Fca.org.uk (2013) *Price Stabilisation Rules (MAR 2)*. [Online] available from: http://www.fshandbook.info/FS/html/FCA/MAR/2. [Accessed: 20 April 2014]. The case of FCA vs. Somerset Asset Management LLP, March, 2013 and the prosecution of Carrimjee and the market manipulation of Gazprom and Reliance GDR's in 2010 in London is a good case in point. This event specifically related to placing orders on the market with the intention of inflating the closing price of the aforementioned companies. What is particularly interesting in this example is that the FCA charged Carrimjee; a very senior member of a London FCA licensed firm (as well as a licensed and approved individual) with willful market manipulation and gross negligence for his "intent" and not actions. Fca.gov.uk (2013) *FCA decides to fine Tariq Carrimjee in relation to market abuse committed by RameshkumarGoenka in October 2010*. [Online] available from: http://www.fca.org.uk/news/fca-decides-to-fine-tariq-carrimjee. [Accessed: 29 June 2014].

The Securities market in KSA has had its fair share of malfeasance and fraud, however, the CMA through the CML has attempted to install a semblance of control over the conduct of market players during the last few years. Dispute resolution and the ability of an investor to bring malpractice to light are key components in overseeing negligent conduct. As previously discussed, as a further measure to protect from malpractice in the securities market a further body within the CRSD was created,[414] while the ACRSC [415] functions as backup to litigants who are unsatisfied with a sentence passed by the CRSD. Thus, the right of appeal exists in the event that a decision issued by the "First degree Court" CRSD is unsatisfactory in which the ACRSC is considered as the appellate (or second degree) court. These committees are quasi-judicial bodies; their decisions are regarded as judicial rather than administrative. Their final decisions cannot be appealed to any other judicial body. The independence of this judicial system for securities litigation is regarded as the collective or institutional independence of these quasi- judicial committees from the judicial branch of the government.[416]

Notably, as per Article 25 of the CML, both the CRSD and the ACRSC are fully independent of one another and have separate mandates within which to discharge their duties.[417] There are three types of securities cases that the CRSD has jurisdiction over:

- Civil cases: Complaints between investors, the CMA and Tadawul.
- Penal cases: Complaints brought forth by the CMA against specific violators of the CML.
- Administrative cases: Review claims against the decisions made by the CMA or Tadawul.

As per the data exhibited on the CRSD website, in 2010 there were 114 cases presented of which 93 were dealt with via the civil suit; 11 cases dealt with via penal suit and 10 cases through Administrative suit.[418] The number of cases dealt with by the CRSD in 2009 [419] and 2008 [420] were significantly higher (140 & 175 respectively) probably as a result of KSA market crash. The CRSD also publishes and announces its cases on its official

[414] Crsd.org.sa (2014) *About CRSD*. [Online] available from: http://www.crsd.org.sa/En/Dispute/Pages/AboutMOC.aspx. [Accessed: 18 August 2014].
[415] Crsd.org.sa (2014) *About ACRSC*. [Online] available from: http://www.crsd.org.sa/En/Dispute/Pages/AboutMOC.aspx. [Accessed: 18 August 2014].
[416] See Alanazi (2012) *'Investor Protection and the Civil Liability…', supra* note 5, at 291. See also Al-Ghadyan, A. (1998) The Judiciary in Saudi Arabia. *Arab Law Quarterly*. Volume 13. Issue 3.235, 246–47, in which he explained the reason for establishing such judicial committees: "There are several administrative committees with judicial powers. These committees were established as a result of the *Shari'a* Courts judges' unwillingness to apply Government regulations, fearing that they may contain provisions that are not in strict compliance with the *Shari'a* Law."
[417] Crsd.org.sa (2014) *Q and A*. [Online] available from: http://www.crsd.org.sa/En/Pages/QA.aspx. [Accessed: 25 February 2014].
[418] Crsd.org.sa (2010) *Incoming Cases in 2010*. [Online] available from: http://www.crsd.org.sa/En/Dispute/Documents/CRSD-2010E.pdf. [Accessed: 7 March 2014].
[419] Crsd.org.sa (2009) *Incoming Cases in 2009*. [Online] available from: http://www.crsd.org.sa/En/Dispute/Documents/CRSD-2009E.pdf. [Accessed: 7 March 2014].
[420] Crsd.org.sa (2008) *Incoming Cases in 2008*. [Online] available from: http://www.crsd.org.sa/En/Dispute/Documents/CRSD-2008E.pdf. [Accessed: 7 March 2014].

website[421] as a means of promoting and enhancing transparency in the market as well as boosting investor confidence.

Notably, all cases brought before the CRSD to date only relate to KSA citizens and/or entities. Progression towards a body that will eventually deal with foreign investors is as yet unknown. Penalties are also stated for the public to view.[422] For example, in 2009, KSA reported a high profile case where the prominent Chairman of a company was alleged to have abused his position on the Board of the company and used the information in his possession to profit from trading in the shares of the company. The chairman of Bishah Agricultural Development Co. was sentenced to three months in jail after he was found guilty of insider dealing. At that time, Reuters reported that market watchers said it was the first time stock market violations had led to a jail term.[423]

Despite the above, unusually, a majority of the CRSD sentences appear to be passed "in absentia," where the defendant has obviously run off without further communication and where the authorities are forced to pass sentence and disperse judgment via official gazette. Moreover, with regards to the issue of transparency, KSA institutions have been and perhaps may continue to be notoriously reticent in publishing information or judgments. Although the CRSD has posted their judgments online for the public to view, other cases, in particular involving the CMA, remain silent.[424] The CMA's policy appears to be underpinned by concern that disciplinary outcomes, specifically the announcement of sanctions against AP's may affect the development of the local market by adversely affecting investor confidence in the market and investors willingness to continue to conduct business with the entity concerned.Although it is clear that substantial penalties have been levied by the CMA Board, the regulatory effect of these actions are not clearly understood by the investment community due to the lack of transparency relating to the violating conduct and the sanctions that have been imposed in respect of them. The policy of the CMA has traditionally been seen as discouraging regulated entities from proceeding to CRSD since anonymity may be more significant to them than obtaining a review of the efficacy of the CMA's findings.[425]

Generally speaking, therefore, the availability of public information can be difficult to access. Unfortunately, answering these questions is a matter of speculation, given the general tendency for courts and judicial tribunals in KSA not to publish their decisions. This

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[421] Crsd.org.sa (2014) *Vision, Mission and Goals*. [Online] available from: http://www.crsd.org.sa/En/Pages/All Announcements.aspx. [Accessed: 16 June 2014].

[422] See Crsd.org.sa (2014) *Announcement from CRSD*. [Online] available from: http://www.crsd.org.sa/En/ Pages/AnnouncementsaeedEN.aspx. [Accessed: 5 May 2014].

[423] The CMA statement indicated that the CRSD issued a final verdict against Najm-Eddine Dhafer. The watchdog said Dhafer conducted "insider dealing in Bishah shares based on him being the chairman chairing the company's board." He was also fined and ordered to repay any profits made. See Reuters.com (2009) *Saudi Court Gives First Jail Term for Stock Market Violation*. 18 August 2009. [Online] available from: http://blogs.reuters.com/financial-regulatory-forum/2009/08/18/saudi-court-gives-first-jail-term-for-stock-market-violation/. [Accessed: 21 August 2014]. Another decision where the CRSD required an accused person to pay to the CMA's account the gains that resulted from violations, amounting to SAR 16,837,224 (US$4,489,387). See Crsd.org.sa (2006) *CRSD Decision No 43/L/D1/2006 of 1427 H issued 01/09/2006 G*. [Online] available from: http://www.crsd.org.sa/En/Disputes/27-43%20E.pdf. [Accessed: 18 August 2014].

[424] Alhilali (2011) *'Analysts: Capital Market Authority Is in Need of Reforms'*, *supra* note 372.

[425] *Ibid*.

contributes to the persistence of uncertainty among both the general public and prospective foreign investors, given that practitioners may only obtain answers to such questions through their own litigation and not through recourse to any settled, clear and accessible legal principles.

These issues of uncertainty are in direct conflict with both the importance of certainty and clarity of the law for efficient securities markets and KSA public policy of attracting foreign investment for the purpose of job creation and economic growth. An essential requirement for the improvement of KSA's image is that decisions made be published which would help in determining the position of KSA law and would allow the development of general theories for KSA financial securities laws.

Unyielding enforcement of laws is as important as the strength of their drafting processes and the final write up of their provisions. This is in addition to the fact that adjudication of business disputes requires an effective and independent judiciary that ensures the rule of law. Stout enforcement of laws by courts is crucial to protecting investors and promoting investment in securities markets.[426] Empirical works have shown that despite the fact that regulators hold the enforcement of the legal rights of investors as a matter of prime importance in KSA; the actual enforcement is shown to be humble at best.[427] The KSA's CMA Law of 2003 establishes specialised securities courts that in securities market disputes. Such move was thought to develop an effective and fair mechanism for securities disputes, however; deficiencies in dispute resolution continue to be seen. Such deficiencies were blamed on ineffective enforcement of securities laws and, in particular, civil liability provisions. Other weaknesses were found by interested researchers; including but not limited to: insufficient number of securities courts, lack of experienced and efficient judges and lawyers, ineffective CMA role in bringing civil suits on behalf of investors, and inadequate remedial powers.[428]

An example is the court remedial power of the account of profit.[429] This can be brought by the CMA on behalf of investors, where the violator may be obliged 'to pay the CMA the gains realised as the result the violation.' [430] Therefore, the account of profit is available against persons who have made a profit based on a violation of the provisions of

[426] See La Porta, R. et al. (1999) Investor Protection: Origins, Consequences and Reform. *National Bureau of Economic Research*. (Working Paper No 7428). 32; and Bufford, S.(2006) International Rule of Law and the Market Economy-An Outline. *Southwestern Journal of Law and Trade in the Americas*.Volume 12(2).303, 310.
[427] According to the annual reports released by the CMA, there were just 38 civil suits finalised out of the 211 civil suits filed during 2009 and 2010. These figures demonstrate the weak performance of the CRSD. In addition, the performance of the ACRSC is no better than that of the CRSD. For example, there were 75 decisions issued out of 187 appealed cases in 2009. Accordingly, it can be reasonably argued that although the law stipulates a fixed period for the disposal of a case commenced before the CRSD, the number of resolved cases is very low when compared with the number of cases lodged within the same period. See Alanazi (2012) *'Investor Protection and the Civil Liability…', supra* note 5, at 326-317.
[428] *Ibid*., 291.
[429] Under the CMA Law of 2003 (Paragraphs 1–9 of Article 59(a)there are legal remedies as well as equitable ones. The former remedies include the compensation and monetary fine. The latter remedies are: injunction, specific performance, rectification account of profit, trading suspension, barring the violator from acting as a broker, seizing property, imposition of a travel ban, and barring the broker from working with companies whose securities are traded on the exchange.
[430] This remedy is found in Art 59(a)(4) of the KSA CMA Law of 2003, *supra* note 2.

CML of 2003 and the CMA rules and regulations. This remedy has been imposed by the CRSD in several cases, none of which concerned defective disclosures in a prospectus, or in continuous disclosure and periodic disclosures. The available cases are mostly associated with the violations concerning insider trading.[431]

The major weakness of this remedy that should be mentioned is that the sole plaintiff permitted is the CMA. As stated in Art 59(a)(4), the CMA alone is allowed to seek the remedy of 'account of profit' before the court. The practice in KSA differs to that in a number of common law countries in this regard, for while an account of profit is about taking away the gain, victims must be able to be recompensed for the loss and damages they suffer as a result of that illegal gain.[432] Individuals must have the right to prevent violators from retaining gains made, based on a breach of the market laws, and the victims of such breaches should have the right to claim their loss after the gain is paid to the CMA's account.[433]

In addition, it has been argued that the protection of investors has been also weakened in KSA by the inefficient enforcement of securities laws. Thus, it is noted that improvements are required in order to achieve an effective judicial enforcement of securities laws and in view of the present situation, members of the securities courts lack accountability.[434] There are no specific standards or requirements for the evaluation of the performance of the securities courts. The CRSD can issue civil, administrative and penal decisions, including imprisonment. Leaving its members without accountability may lead to undermining their performance.[435] In KSA, therefore, lack of confidence in the judiciary precludes investors from going to law courts for judicial remedies. Investors are either reluctant or incapable of going to court for judicial remedies. Therefore, recently, Saudi stock exchange financial analysts deduced that the market conduct laws and regulations require reforms associated with fair trial and the need for transparency in dealings.[436]

The UAE legal system which regulates all of the UAE financial markets exhibits inadequacies under both the Federal Criminal Law No. 3 of 1987 and the Federal Law No. 8 of 1984 Concerning Commercial Companies for dealing with market abuse practices. The Criminal Law does not encompass cases of financial crimes such as market abuse. In fact, insider dealing regulation in the UAE local financial markets only involves particular types of fraudulent procedure that are examined under only two articles of the SCA Federal Law of 2000.[437]

[431] For example see the CRSD Decision No 43/L/D1/2006 of 1427 H (issued 01/09/2006 G), *supra* note 423.
[432] Tilbury, M. (2003) Reconstructing Damages. *Melbourne University Law Review*. Volume 27. Issue 3.
[433] Alawaid, K. (2006) The CRSD Obliges Alqhtani to Return His Gains in Share Market to the CMA's Account Because of the Violation of Regulations. *Alriyadh*. 14 December 2006. [Online] available from: http://www.alriyadh.com/2006/12/14/article208887.html. [Arabic]. [Accessed: 21 August 2014].
[434] Alanazi (2012) *'Investor Protection and the Civil Liability…', supra* note 5, at 336.
[435] *Ibid*.
[436] Alhilali (2011) *'Analysts: Capital Market Authority Is in Need of Reforms', supra* note 372.
[437] See Articles 37, 39 respectively of the SCA Federal Law, *supra* note 75. The same articles are reflected in the SCA Regulations as to Disclosure and Transparency of 2000, Articles 37, 38, 39, *supra* note 275. For more details, see Chapter Five, Para. 5.4.1, *supra*.

Not only that the related articles contain no clear definition of inside information but to certain extent set some of it characteristics, such as 'affecting prices of securities' and 'unpublicised or undisclosed information.' Moreover, the definition is insufficient, because it does not specify the magnitude of price fluctuation that may have been induced by information if released to the market or, conversely, whether this data is specific, precise, or factual.[438] It is surprising that such poorly drafted articles are designed to deal with such a complex act as insider dealing. The matter is compounded by introducing criminal offences while the Law sets no clear definition of the punishable act. Moreover, neither of the terms 'unpublicised' or 'undisclosed' information is defined or brought under guidelines. The two terms are not synonymous, since 'or' means that fulfilling one criterion is sufficient. These terms are rather eccentric, and cannot be compared to the definition of 'inside information' in recognised jurisdiction in order to reach a reasonable definition.[439]

Also the meaning of 'by virtue of his position' is not clear. It implies that only directors are liable, where the law should also include employees and people who have access to information because of their profession, such as lawyers and accountants. Article 37 also provides no definition of 'exploits' and 'unpublicised information.' The scope of the prohibition in this Article is another shortcoming. It only prohibits exploiting inside information by dealing in securities; however, disclosing such information to a third party such as friends or relatives is not prohibited. Insiders may also seek indirect benefits by establishing networks to exchange inside information.[440]

While Article 39 of the SCA Disclosure and Transparency Regulations is clearer in determining liable insiders, as it provides a list of primary insiders; including the chairman, the members of the board of directors, the general manager and any of the employees of the company. However, the use of the term of 'inside information' in this Article also creates an ambiguity, since in the three articles of such Regulations that address inside dealing; different terms are used for the same concept.

The comparison of the SCA legislation to that in the UK's, certainly, has showed that the regulatory system may be deficient in some areas, such as the definition of inside information. Under the SCA Law there is an absence of a requirement that inside information should be precise or relevant to particular securities or to an issuer of securities.[441] In contrast, these requirements are provided by the UK laws. In addition, the SCA Law 2000 and respective Regulations did not provide a clear a definition of the act of insider dealing. It limited the scope of insider by providing that 'any person' must obtain the inside information by virtue of his or her position. The 'position' as a term made for a shortage of the law by not including secondary insiders and because it is based on the meaning of Arabic rather than it

[438] Al Shamisi, H. S. (2010) Investigation into Market Abuse in the UAE Financial Markets: A Comparative Legal Study. *PhD Thesis*. University of Exeter. 153.
[439] Albelooshi (2008) *'The Regulation of Insider Dealing…,' supra* note 251, at 85-87.
[440] *Ibid*, 87.
[441] See Alhamrani, S. R. (2011) Insider Dealing In the Stock Market Environment: A Comparative Study between American. British and Emirates laws. *PhD Thesis*. University of Leeds. See also Al Shamisi (2010) *'Investigation into Market Abuse in the UAE…', supra* note 438, at 202.

in English.[442] This makes the SCA Law 2000 inadequate in covering all offences that come under market abuse. The Law prohibits only the exploitation of inside information, although it does not clarify what amounts to the exploitation of inside information.[443]

The UK used different approaches for prohibiting market manipulation. The law uses specific wording to cover a wide range of illegal practices of market manipulation. It prohibits any conduct that leads to deception of investors or actions that create an artificial impression, or cause the creation of an improper appearance relating to demand or the supply of, or the value of an investment. The UAE legislations are obviously lacking in terms of the extent of their prohibitions against some practices related to market manipulation. As will be seen later in the case of the DIB's shares, the SCA law 2000 does not encompass provisions applied to market manipulation such as matched orders and market cornering practices.[444]

Therefore, the above Law has not presented a comprehensive decision regarding the practice of insider dealing and market abuse and the related provisions to insider dealing are inadequate to safeguard market integrity and to protect investor interests.[445] The practice of insider dealing cannot be addressed, controlled or prevented when the law is not sufficiently clear or when it has several shortcomings and legal loopholes.

Not only those provisions against insider dealing under the above law are not adequate, but also abiding by these provisions is not yet common practice.[446]The number of cases that have been brought before the national courts is not clear, but even this has not been enough to reduce the prevalence of these practices and to ensure that the provisions of the SCA Law of 2000 are applied.[447] Despite the ambiguity in regards to the cases that were presented to the courts, the SCA announced that between 2007 and 2009, it detected approximately 721 cases of market manipulation,[448] however none of these cases revealed insider dealing.

Since there are no reported cases on insider dealing, an examination of the outcomes of the first well-known case on market manipulation of 'Dubai Islamic Bank' can give insights to the deficiencies about the justice system in relation to market manipulation under the SCA Law 2000.[449] In this case the Court of First Instance applied Article 41 of the above law and fined defendants 1,000,000 Dirhams, but the value of the transactions carried out by the defendants reached 9.34 billion Dirhams. The fine imposed should not be less than the

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442 *Ibid*.
443 *Ibid*., 190.
444 *Ibid*., 260-61
445 *Ibid*. See also Albelooshi (2008) *'The Regulation of Insider Dealing…,'supra* note 251; and Alhamrani (2011) *'Insider Dealing In the Stock Market…'*, *supra* note 441, at 253-54.
446 Al Shamisi (2010) *'Investigation into Market Abuse in the UAE…'*, *supra* note 438, at 248.
447 *Ibid*., 153.
448 See the Annual reports of the SCA 2007, 2008 and 2009. See Sca.gov.ae (2014) *SCA Annual Report (2007)*. [Online] available from: http://www.sca.gov.ae/Arabic/Publications/Pages/Reports.aspx. [Arabic]; and Sca.gov.ae (2014) *SCA Annual Reports (2008-2013)*. [Online] available from: http://www.sca.gov.ae/English/Publications/Pages/Reports.aspx. [Accessed: 10 October 2014].
449 The case envisages three forms of market manipulation; matched orders, corner action and disseminating false information. For full examination of the case, see Al Shamisi (2010) *'Investigation into Market Abuse in the UAE…'*, *supra* note 438, at 248-56.

expected profits to be obtained or the loss to be avoided.[450] In terms of regulation by the SCA, there appears to be an inability of the Authority to perform its natural role of controlling the mechanisms of the market or in reducing illegal practices engaged in the market. As there was a huge circulation of DIB shares on the DFM because of the manipulation of the market, this eroded public confidence in the markets and served as an example of the need for more supervision.[451]

In this case, the court heavily relied on the experts' report, which significantly altered the court's opinion. Therefore, the Court of Appeal acquitted the defendants from the charges of market manipulation on the basis of the expert report alone. This raised the important issue of the influence of specialist courts or judges. It therefore supports the opinion that creating specialist judges for crimes relating to the financial market is necessary because regular judges are unable to understand technical matters relating to securities transactions. The lack of the judges' expertise gives a reasonable explanation as to why the Court leaned so heavily upon on the technical expertise of the expert report and why the Court of Appeal acquitted the defendants from the charge of market manipulation. It also introduced the concept of criminal reconciliation, and the need to publish offenders' names and proportional fines.[452]

Moreover, to be able to determine the civil and criminal consequences about the fate of the contract concluded as a result of using material non-public information in securities trading requires consideration of the legal approach in the comparative laws, which stipulate that the contract shall be void if it was concluded as the result of the commission of a crime or if it conflicts with the public order and morals as in most Arab countries, including KSA and the UAE. This rule was taken originally from classical Islamic law.[453] Therefore, under the Law of 2000, violators are not required to disgorge illicit profits;[454] however it is possible under KSA CML as previously indicated.

In addition, considering the view that insider dealing is a victimless crime;[455] it is difficult to identify the contracting parties in the automated trading system in the securities market to enable one of them to seek the annulment of the contract. For that, the UAE legislation, like other GCC countries, does not set special rules for the civil liability resulting

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450 *Ibid*. However, compare with the case of DIFC v Shuaa Capital International Limited 2008 where Shuaa Capital, one the UAE's largest investment companies, was fined nearly 3.5 million Dirhams ($850,000 for the market manipulation, and $100,000 for the obstruction of the DFSA's investigation) in 2008 for manipulating the price of DP World's shares and then obstructing an investigation into the case. The DFSA indicated that Shuaa Capital had intentionally set about raising the closing price of DP World shares on March 31st 2008, so that it could mark up the book value of its proprietary portfolio in those shares for accounting purposes. Essentially, Shuaa Capital ended up closing its mark-to-market portfolio value at a massive premium to previous closing, thus boosting net profit (although this was not an actual cash gain). Shuaa did this by standing in the market during the closing minutes of trading with bid prices well above those at which the shares had been trading at that day. The penalty at the time imposed by the DFSA was significant. Dfsa.ae (2008) *Enforceable Undertaking - Shuaa Capital*. September 2008. [Online] available from: http://www.dfsa.ae/Documents/EU%20-%20Shuaa%20Capital%20-%20September%202008.pdf.[Accessed: 3 October 2014].

451 Al Shamisi (2010) *'Investigation into Market Abuse in the UAE…'*, *supra* note 438, at 135.

452 *Ibid*, 130-32, 135.

453 Comair-Obeid, N. (1996) Particularity of the Contract's Subject Matter in the Laws of the Arab Middle East. *Arab Law Quarterly*, Volume 11. 347, and in general, see 331-349.

454 Alhamrani (2011) *'Insider Dealing In the Stock Market…'*, *supra* note 441, at 251, 291.

455 Hetherington, J.A.C. (1967) Insider Trading and the Logic of the Law. *Wisconsin Law Review*. Issue 3, 720.

from trading. Hence, the legislations in above counties do not pay attention to the issue of civil liability for the offence of insider dealing, but instead leave it to the general rules of the Civil Code.[456]

The UK legislator, however, provided the FCA to disgorge the profits obtained by insider dealing from the wrongdoer to the company in question, even if he was a secondary insider (tippee). Under the authorisation of Section 383 of the FSMA 2000, the FCA has the power to order, through the court, any offender to disgorge what he gained through illegal insider dealing to those injured by such dealing.[457] Although, the UK Act of 1980 did not protect the victims of insider dealing with regard to civil accountability, yet, the common law was applied to address this shortcoming. The implementation of the common law was initially through two theories, fiduciary duty and breach of confidence. This situation was changed when the government introduced the FSMA 2000 that provides a civil remedy for a victim of insider dealing.[458]

In the UAE, if the offence of insider dealing is in connection with the management of a company, the SCA will not be able to disqualify company directors and officers who have been convicted of, or pleaded guilty to, the offence. The law does not empower the SCA to do so, but the law does leave this power to the courts. It is obvious, therefore, that the disqualification penalty is a valuable instrument in the developed markets, such as the UK, for deterring insider dealing.[459]

Although the offence of insider dealing can lead to criminal and civil penalties, it is subject to a number of defences. The legislature of the UK has realised that many persons who act in good faith can be affected by the generalisation of the prohibition of insider dealing. Accordingly, while the Emirati legislator has not provided any special defences to the charge of insider dealing, the UK regulations contain safe harbours against such a charge. The CJA 1993 and FSMA 2000 contain defences that can protect any person who possesses price sensitive information that are not generally available against the charge of insider dealing.[460] Hence, the existence of a legitimate justification for trading in securities by someone who knows material non-public information opens the door widely to a successful defence against the charge of insider dealing. In contrast, in the UAE, no statutory defences

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[456] The rules of civil liability prescribed from Article 282 under Chapter Three and onwards of the Federal Law No. 5 of 1985 on Civil Transactions. See Glossarissimo.wordpress.com (1985) *Federal Law No. 5 of 1985 on Commercial Transactions.* [Online] available from: https://glossarissimo.wordpress.com/2014/10/29/en-doc-federal-law-n-5-1985-on-the-civil-transactions-law-of-the-united-arab-emirates-state-box-com/. [Accessed: 21 April 2014]. See also Alhamrani (2011) *'Insider Dealing In the Stock Market…'*, *supra* note 441, at 222.

[457] The Enforcement Guide, Chapter 11 Restitution and Redress. See Fca.org.uk (2014) *The Enforcement Guide*. 1st April 2014. [Online] available from: http://media.fshandbook.info/Handbook/EG_Full_20141212.pdf. [Accessed: 20 August 2014].

[458] See McVea, H. (1996) Fashioning a System of Civil Penalties for Insider Dealing: Sections 61 and 62 of the Financial Services Act 1986. *Journal Business Law*. 345-47; and Rider et al. (2009) *Market Abuse and Insider Dealing, supra* note 395, at 43-45.

[459] Alhamrani (2011) *'Insider Dealing In the Stock Market…'*, *supra* note 441, at 239.

[460] The UK legislation provides two types of defences. First, defences to the criminal allegation covered by the CJA 1993 in section 53 and schedule1. These defences are also classified into two categories, known as general defences and special defences. Section 53 provides seven defences to insider dealing. Second, the defences to the civil suit are 'safe harbours', which were introduced by the FSMA 2000 and the Code of Market Conduct. For further details, see Rider, et al (2009) *Market Abuse and Insider Dealing*, *supra* note 395, at 65-87.

protect investors if the element of good faith is present. That could affect innocent individuals who, in good faith, traded while in possession of material nonpublic information or passed it on to others.

The recent trend in the regulation of insider dealing is to delegate to the regulator the power to enforce civil/administrative fines to deter insider dealing. This is not given to the SCA in the UAE, but it is apparent in the reforms in the UK. Combining more than one kind of penalty has been efficient in combating insider dealing. For a long time, the UK system depended on criminal sanctions. These were thought to be a main reason for the limited number of successful prosecutions of insider dealing. Therefore, the UK government adopted a civil/administrative regime through the FSMA 2000 as a more practical weapon to deter insider dealing.

In short, there are many deficiencies in the SCA regulations in respect to insider dealing. While the legislations the SCA have prohibited exploiting inside information but they did not characterise this information. There is no particular requirement that inside information should be specific or precise. The SCA regulations also did not require that inside information should be relevant to particular securities or to an issuer of securities. Both of these requirements (precise and relevant to) are omitted by the UAE Decision, which contrast to the UK laws.

Further, those regulations did not define the insider properly. Article 39 defines an insider as 'any person,' but it limited the scope by providing that 'any person' must obtain the inside information by virtue of his or her position. In this sense this definition did not include secondary insiders under this Article. The term 'position' has a special meaning in the UAE culture as referring to one who is usually on the top of the hierarchy in entities. In fact, it is a different meaning in Arabic than it is in English. This creates a loophole in the legislation which may reflect the impracticality of successful prosecution.[461]

Moreover, it also did not criminalise three behaviours: 'leaking of inside information' to friends or others, 'procuring' or 'encouraging' another person to deal. Therefore, the SCA Regulations suffers from an inadequacy by not criminalising these behaviours. Moreover, the Decision does not criminalise the action of using inside information without requiring that the person should benefit from his action. As soon as the action is executed a crime has occurred and it is against the rule of equality and fairness between the investors with regard to access to inside information. It is opposed to the UK legislation which has criminalised the action without requiring the benefit. Accordingly, the UAE legislature should criminalise the use of inside information without requiring 'personal benefit.'[462]

In addition, many judicial authorities rely on different legal systems, which lead to different approaches towards essential concepts that are used to provide definitions of market manipulation and the types of sanctions imposed. Even though the UK jurisprudence, does

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[461] Al Shamisi (2010) *'Investigation into Market Abuse in the UAE…'*, *supra* note 438.

[462] See *ibid.*; Albelooshi (2008) *'The Regulation of Insider Dealing…'*, *supra* note 251; and Alhamrani (2011) *'Insider Dealing In the Stock Market…'*, *supra* note 441.

not provide definition for market manipulation but it focused on behaviours which may amount to market manipulation practices. The SCA Regulations, on the other hand, lack the definition of such practices and have shortcomings in terms of prohibiting some practices related to market manipulation.

Although the SCA Law does not criminalise market manipulation such as matched order, wash trades and such other practices which mislead investors, however; it criminalises actions of fictitious transactions under Article 26(2) of the SCA Law of 2000, only if it is committed by brokers. Yet, this has been a drawback in the Law since the criminal responsibility for fictitious transactions has been fixed only against a broker whereas other market participants would go without a punishment. This deficiency should be remedied by criminalising any conduct that constitutes or creates an artificial price through false or misleading impression of trading.[463] Furthermore, where the UK law imposes severe criminal punishment upon those who commit insider dealing that goes from seven years up to twenty years in prison.

In contrast, a prison term in the UAE is not less than three months and not to exceed three years. Moreover, not only there is no effective method to prevent the act of market manipulation from taking place in the financial markets, it is also difficult to prove whether transactions and trading in the market are manipulative or not. The main protection for investors and the market from such practices should be provided by the supervisory authorities of the CMA and the SCA. Therefore, certain steps are required to be taken by those authorities to avoid the above deficiencies. However, even if the SCA attempts to remedy these deficiencies by issuing further rules and regulations, the sanctions imposed by the rules, and regulations are not sufficiently severe for deterrence of these crimes.[464]

## 6.5 The Problems Related to False Accounting

The UK Serious Fraud Office states quite clearly that false accounting is the falsification, concealment or destruction of records and is mostly used to trick innocent investors or people into parting with money or other property or to cover up what has already been done by falsifying accounts.[465] False accounting is an offence under the Theft Act 1968 Section (17) and is punishable by prison sentence and/or fines. The intent of falsifying accounts is usually either to hide/omit a previous falsification or to deceive others for monetary gain. The Act defines false accounting as follows:

> "Where a person dishonestly, with a view to gain for himself or another or with intent to cause loss to another (a)destroys, defaces, conceals or falsifies any account or any record or document made or required for any accounting purpose; or (b)in furnishing

[463] Al Shamisi (2010) *'Investigation into Market Abuse in the UAE…'*, *supra* note 438, at 407.

[464] Gulfnews.com (2015) *New law expected to have harsher penalties for stock exchange fraud, manipulation*. 7 January 2015. [Online] available from: http://m.gulfnews.com/business/markets/new-law-expected-to-have-harsher-penalties-for-stock-exchange-fraud-manipulation-1.1437848. [Accessed: 8 January 2015].

[465] UK Serious Fraud Office (2013) *operational handbook*. [Online] available from: http://www.sfo.gov.uk/media/106054/false_accounting_sfo_operational_handbook_topic.pdf. [Accessed: 2 May 2014].

information for any purpose produces or makes use of any account, or any such record or document as aforesaid, which to his knowledge is or may be misleading, false or deceptive in a material particular; he shall, on conviction on indictment, be liable to imprisonment for a term not exceeding seven years." [466]

Another definition is that false accounting is the concealment, falsification or destruction of records in order to mislead people and/or stakeholders into departing with money or assets.[467] False accounting is also used to cover up or hide misrepresentations of fraudulent activity which has already taken place.

The impact of false accounting on the capital markets considered one of the systemic risks that threaten the markets' stability and causes serious harmful damages to the investors, which means that false accounting is directly related to the investors' protection principle, hence, it is one of the most regulatory challenges globally. The key reason behinds this consideration is the fact of the importance of presenting "fair" financial information to the investors as a part of investors' protection, and fair markets theory. Furthermore, the importance of presenting fair financial information is critical to the whole economy and the regulatory framework to prove that there are strong corporate governance principles in place and enforceable through sufficient legal system.[468]

Investors around the world require transparent and fair financial statements in order to take their investment decisions to become shareholders in any particular company, fund managers and financial advisors use these statements to build their investment strategies and provide their investment advices, which means that inappropriate financial statements will lead to inappropriate investment decisions and advices, therefore, inappropriate market's behavior and lack of rationality, all of this will results financial damages to the investors.[469] The importance of presenting "fair" and appropriate financial statements exceeds the scope of investors and the company's shareholders, as there are other parties that are concerned about these statements. These parties include the group of company's stakeholders such as: regulatory bodies, creditors and suppliers.

All these groups look for "fair" and appropriate financial statements to build their decisions on them. For instance, regulatory bodies will be concerned about the statements for the matters related to investors protection as mentioned above. Creditors like banks and bondholders are one critical group that will be examining the financial statements of company to assess its financial position and profitability in order to provide the company with any funds or loans. The same concept applies to the suppliers during the commercial

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[466] Legislation.gov.uk (2014) *The Theft Act 1968*. Section 17. [Online] available from: http://www.legislation.gov.uk/ukpga/1968/60/section/17. [Accessed: 6 May 2014].
[467] The UK Operational handbook, *supra* note 465.
[468] Tak, I. (2011) Impacts and Losses Caused By the Fraudulent and Manipulated Financial Information on Economic Decisions. *Review of International Comparative Management*. Volume 12. Issue 5.
[469] *Ibid*.

transactions which requires a due diligence when companies and financial institutions deal with each other.[470]

Therefore, there are a set of principles and guidelines that are globally recognised to govern the matter of financial reporting and accounting treatments, these principles are the International Accounting Standards "IAS" and the International Financial Reporting Standard "IFRS." [471] Listed companies around the globe are obliged to prepare and present their financial statements based on these principles, hence, these companies are usually obliged to appoint external auditors whom responsibility is to ensure that these financial statements are prepared according to the IAS and IFRS and any other local regulatory requirements. The company's directors are responsible to provide the stakeholders, the investors and markets with "fair" and appropriate financial statements that represent the financial position of the company clearly and without any false information, which means that those directors are accountable for performing the cares duties to provide fair financial statements.

This concept plays a big role in solving the agency problems as owners of the company "shareholders" demanding the highest level of transparency and disclosure related to the financial performance of the company which is run by the management, therefore, false accounting can increase agency problems and result lack of trust in the markets. In other words, financial reporting and disclosure are potentially important means for management to communicate firm performance and governance to outside investors.[472]

Although the term false accounting is referring mainly to the matter of intention, there is another aspect that shall be considered which is the professional responsibility and the care duties – or what is called fiduciary duties – that the directors and the company have to perform. False accounting could be a result of insufficient internal controls or not performing professional cares duties, which is considered as negligence under the tort law in most of the legal systems.[473] Therefore, false accounting concept could be extended to include all the case where proper cares duties aren't conducted by the company, as this may lead to lack of sufficient internal controls and weakness of policies and procedures that governs and supervise the process of preparing and auditing the financial statements of the companies, and as a result will increase the risk of false accounting either directly or indirectly. There are many cases of false accounting that have proven how much this matter could be harmful to the markets and investors, several cases from the UK, KSA and the UAE will be discussed.

[470] Barth, M. E., & Landsman, W. R. (1995) Fundamental issues related to using fair value accounting for financial reporting. *Accounting Horizons*. Volume 9. Issue 4.

[471] The US is using accounting principles that are known as Generally Accepted Accounting Principles "GAAP" and there are some countries around the world that are using such principles. Despite the convergence between the IFRS and GAAP, the international efforts have been increased in the last few years to consolidate these principles to have one consolidated reference for accounting treatments and financial reporting. See, e.g., Hlaciuc, E. et al. (2009) Some Issues about the Transition from U.S. Generally Accepted Accounting Principles (GAAP) to International Financial Reporting Standards (IFRS). *Annales Universitatis Apulensis: Series Oeconomica*. Volume 11. Issue 1.

[472] Palepu, K. G. & Healy, P. M. (2001) Information asymmetry, corporate disclosure, and the capital markets: A review of the empirical disclosure literature. *Journal of Accounting & Economics*. Volume 31. Issue 1. 31, 405.

[473] Tak, I. (2011) *'Impacts and Losses Caused…', supra* note 468.

In the UK, the case of Micalizzi in 2010 [474] is a good example of this type of crime. Between 1 October 2008 and 31 December 2008, an investment firm's master fund suffered catastrophic losses amounting to approximately 85% of its value in volatile market conditions following the collapse of Lehman Brothers. The defendant, the CEO of the firm, Alberto Micalizzi, knowingly and deliberately concealed these massive losses from investors whilst advising them that no losses had been made. To conceal his losses the CEO then went about concealing and falsifying accounts and records to cover up. The FSA had opened an investigation and then imposed a fine of UK£3,000,000 on him which made it one of the heaviest fines ever imposed by the FSA. [475]

Of course, this neatly ties in with the large host of other issues primarily related to corporate governance, general duties and responsibilities of directors as well as financial reporting and accounting responsibility. No doubt, the FCA takes a very serious view of this type of fraud and the imposition of such a heavy fine as well as revocation of FCA granted license sends a strong message to the market participants that this type of behavior is unacceptable for those individuals deemed to be fit and proper. Thus, criminal liability is imposed for obtaining property or pecuniary advantage by deception and for false accounting. Where such an offence is committed by a company with the consent or connivance of a director or other officer, that person will be liable as well as the company.

Under KSA's legal system, the matter of negligence is implied as a part of the Islamic Law *Shari'a* system which is governing the whole legal system. One of the features of Islamic law is that the owner of an item bears the risk of loss or damage in relation to that particular item. Accordingly, it should be noted that risk of loss or damage cannot pass unless ownership passes. That said, risk could actually pass without ownership passing where either (i) a person is in the business of looking after/protecting/maintaining the asset left in his care; or (ii) the asset is lost or damaged by a negligent/wrongful act.[476]

Although, a direct reference to the term "false accounting" in KSA is unavailable in the CML, nonetheless, several references to falsification, concealment and fraud are made with regard to conduct of market participants in KSA equity capital markets. Additionally, penalties for the provision of false information are quite stringent. Persons who engage in dealing activities without authorisation or who violate prohibitions against market manipulation or insider trading may be subject to imprisonment.

[474] Fsa.gov.uk (2013) *FSA Decision Notice 2012; Alberto Micalizzi*. 20 March 2012. [Online] available from: http://www.fca.org.uk/static/pubs/decisions/alberto-micalizzi.pdf. [Accessed: 26 September 2014].
[475] *Ibid*.
[476] See Majallat al-ahkam al-adliyah (The Ottoman Courts Manual (Hanafi) (1876) Books V. & VI. [Online] available from: http://legal.pipa.ps/files/server/ENG%20Ottoman%20Majalle%20(Civil%20Law).pdf. [Accessed: 23 December 2014]. See also Al-Zarqa, M. (1988) *Harmful Action and Liability*.Syrian Arab Republic: Dar al Qalam Publishers. [Arabic]; Al-Zuhaili, W.(1982) *Liability Theory: Comparative Study*.Syrian Arab Republic: Dar AlFikr Publishers. [Arabic]; Vogel, F. E. & Hayes III, S. L. (1998) *Islamic law and finance: religion, risk, and return*. United States: Kluwer Law International; and Aljadaan.com (2014) *Overview of Saudi Domestic and Foreign Corporate Laws*. [Online] available from: http://www.aljadaan.com/ files/file/Overview_of_the_Saudi_Arabian_Legal_System.pdf. [Accessed: 23 December 2014].

The CMA Board itself, under the power contained in the CML has the right to bring a legal action before the CRSD to seek an order for the appropriate sanction. The sanctions include many measures as well as imposing fines on any person who has violated the CML, or the regulations of Tadawul.[477] The Board may also suspend or revoke the license of an AP who deliberately violates the CML or its Implementing Regulations and if submits false or misleading information in any document filed with the CMA, Tadawul or a regulator in a foreign jurisdiction.[478]

In addition, the CML refers to the CMA Board' rejection of any prospectus issued that attempts in any way to alter material information of a company or that provides false and misleading statements or information to the general public. Issuers that offer securities by way of public offer are subject to disclosure requirements including shareholder voting decisions and provisions for equality of treatment. Furthermore, prospectuses are approved by the CMA and may be rejected in the event a violation is detected. Reporting and disclosure by significant shareholders of listed companies and by persons who would seek control of a listed company are also required. Minimum information requirements for prospectuses require that the prospectus contain sufficient information to enable an investor to assess the issuer's activities, financial position, management and prospects as well as the rights and obligations attaching to the securities. A prospectus must include three years' operating financial results.[479]

A recent regulatory case where accounting failures has a significant impact on the company financials is the KSA's giant telecommunication company Mobily.[480] In November 3, 2014, Mobily announced accounting errors that shall affect the company's profits for 2013 and the first nine months of 2014! These errors forced the company to restate its profits from 6.68 to 5.94 billion Riyals for 2013 and from 1.63 billion Riyals to 472 million Riyals for the first nine months of 2014.[481] The CMA suspended the trading of the company shares and started an investigation [482] to determine any violations by the company to the CML, in

[477] Article 59 of KSA Capital Market Law of 2003, *supra* note 2.
[478] *Ibid*., Article 62.
[479] *Ibid*., Articles 42, 44, 55.
[480] Mobily.com.sa (2014) *Homepage*. [Online] available from: http://www.mobily.com.sa. [Accessed: 26 December 2014].
[481] Reuters.com (2014) *Mobily restates profits for 2013 and first half of 2014*. [Online] available from: http://www.reuters.com/article/2014/11/03/mobily-results-idUSL6N0ST0T420141103. [Accessed: 26 December 2014].
[482] See Cma.org.sa. (2015) *CMA announcement in regard to the suspension of trading the shares of Etihad Etisalat Co. (Mobily)*. 25/02/2015. [Online] available from: http://www.cma.org.sa/Ar/News/Pages/CMA_N_1672.aspx. [Accessed: 26 December 2014]; Cma.org.sa. (2015) *CMA announcement in regards to the assignment of a specialised team to review Etihad Etisalat Co. (Mobily)'s financial statements, conduct site visits, obtain documents and hear concerned parties' statements*. 26/02/2015. [Online] available from: http://www.cma.org.sa/en/News/Pages/CMA_N_1676.aspx. [Accessed: 26 December 2014]; and Reuters.com (2014) *Saudi regulator investigates Mobily after earnings errors*. [Online] available from: http://www.reuters.com/article/2014/11/03/mobily-results-idUSL6N0ST0UA20141103. [Accessed: 26 August 2014].

addition to that, Mobily's board of directors suspended its CEO from acting on his duty till the end of the internal investigations conducted by the company's audit committee.[483]

All listed companies in the UAE are required to submit financial statements annually and quarterly, these statements should be prepared in accordance with IAS as stated in the SCA Regulations.[484] Hence, these companies are obliged to take the necessary processes and procedures to ensure that they conduct the cares duty to provide the investors and all stakeholders with fair and appropriate financial statements. Similarly, in the UAE, false accounting is also used to cover up or hide misrepresentations of fraudulent activity which has already taken place. The boom and subsequent financial crisis saw a multitude of false accounting cases rise to the public notice. In fact, the authorities were attempting to make a direct point to the general population that cases of fraud and theft will not be tolerated in the least. Perhaps one of the most famous cases in the UAE of false accounting, fraud and misrepresentation relates the DIB embezzlement case of over 1.8 billion Dirhams.[485]

Such false accounting occurrences that wiped tremendous amount of shareholders' profits and equity illustrates how such practices could be harmful to the markets and effects the level of confidence among the investors. Therefore, regulatory bodies role in this regard shall be increased to ensure adopting an appropriate regulatory framework and strict financial monitoring on the markets, especially companies that are classified as Systemically Important Financial Institutions "SIFI's."[486] The next Chapter will propose some mechanisms to develop tools to manage false accounting.

## 6.6 The Problems Related to Corporate Governance

Good corporate governance is generally supposed to add or increase the value of a firm. This will expected to be reflected in the stock price and in the buying pressure witnessed on a script throughout a trading day. The governance of firms has become and will continue to become an important issue for investors, foreign institutions and local corporations and is expected to play a central and important role in the further growth of any equity capital markets. Furthermore, it helps investors to identify and compare the corporate governance practices among different companies, and consequently, investors can chose the best alternative investment based on the level of corporate governance practice.[487]

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[483] Kerr S. (2014) CEO suspended at Saudi telecoms group hit by accounting scandal. *Financial Times*. 24 November 2014. [Online] available from: http://www.ft.com/cms/s/0/c186cf94-69cc-11e4-8f4f00144feabdc0.html#axzz3K71TSAiB. [Accessed: 26 December 2014].

[484] Article 36 of the SCA Regulations as to Disclosure and Transparency, *supra* note 275.

[485] Mustafa, A. (2011) Record 10-year sentences over 1.8bn Dirhams DIB fraud case. *The National*. 27 April 2011. [Online] available from: http://www.thenational.ae/news/uae-news/record-10-year-sentences-over-dh1-8bn-dib-fraud-case. [Accessed: 1 June 2014].

[486] Bongini, P. & Nieri, L. (2014) Identifying and Regulating Systemically Important Financial Institutions. *Economic Notes*. Volume 43. Issue 1.

[487] This point is supported by the findings of McKinsey who reported that investors are willing to pay more for the shares of well-governed companies than for those of poorly governed companies, particularly in emerging markets. For more details, seeMcKinsey.com (2000) *Investors opinion survey on corporate governance*. [Online] available from: www.mckinsey.com. [Accessed: 26 September 2014].

The first version of the UK Corporate Governance Code (the Code)[488] was produced in 1992 by the Cadbury Committee.[489] Its paragraph 2.5 is still the classic definition of the context of the Code: "Corporate governance is the system by which companies are directed and controlled. Boards of directors are responsible for the governance of their companies. The shareholders' role in governance is to appoint the directors and the auditors and to satisfy themselves that an appropriate governance structure is in place. The responsibilities of the board include setting the company's strategic aims, providing the leadership to put them into effect, supervising the management of the business and reporting to shareholders on their stewardship. The board's actions are subject to laws, regulations and the shareholders in general meeting." Corporate governance is therefore about what the board of a company does and how it sets the values of the company, and is to be distinguished from the day to day operational management of the company by full-time executives. The Code is a guide to a number of key components of effective board practice. It is based on the underlying principles of all good governance: accountability, transparency, probity and focus on the sustainable success of an entity over the longer term.[490]

The Code rules are based on the "comply or explain" principle.[491] The essence of the principle is that compliance with the codes is not mandatory, but what is compulsory is disclosing non-compliance.[492] It applies to all companies with a Premium listing of equity

[488] Frc.org.uk (2012) *The UK Corporate Governance Code.* September 2012. [Online] available from: https://www.frc.org.uk/Our-Work/Publications/Corporate-Governance/UK-Corporate-Governance-Code-September-2012.pdf. [Accessed: 30 October 2013]. Later, it was replaced by a new Code that applies to accounting periods beginning on or after 1 October 2014. It applies to all companies with a Premium listing of equity shares regardless of whether they are incorporated in the UK or elsewhere. See Frc.org.uk (2014) *The UK Corporate Governance Code.* September 2014. [Online] available from: https://www.frc.org.uk/Our-Work/Publications/Corporate-Governance/UK-Corporate-Governance-Code-2014.pdf. [Accessed: 30 October 2014].

[489] The first serious code of this kind arose from the report of the Cadbury Committee in 1992 set up by the LSE and the UK Financial Reporting Council. In the USA and Hong Kong there were two precursors to this code in 1978 and 1989 respectively. However, those codes were relatively general and did not receive much attention. Apart from many subsequent issuance of different codes by stock-exchange-related bodies, there are also some transnational initiatives like the 'OECD Principles of Corporate Governance', which are not so much directed at companies as such, but are primarily meant as 'guidelines' for legislative and regulatory initiatives in both OECD and non OECD countries. See Oecd.org (2012) *OECD Principles of Corporate Governance*. [Online] available from: http://www.oecd.org/corporate/ca/corporategovernanceprinciples/31557724.pdf. [Accessed: 2 October 2014]; Seidl, D., Sanderson, P. & Roberts, J. (2009) Applying "comply-or-explain": Conformance with Codes of Corporate Governance in the UK and Germany. *Centre for Business Research*. University of Cambridge. Working Paper No. 389. 3, 28; and Keay (2014) *'Comply or explain…', supra* note 143.

[490] *Ibid*.

[491] The Cadbury Report, titled Financial Aspects of Corporate Governance, is a report issued by "The Committee on the Financial Aspects of Corporate Governance" chaired by Adrian Cadbury that sets out recommendations on the arrangement of company boards and accounting systems to mitigate corporate governance risks and failures. The report was published in draft version in May 1992 and the final version was issued in December of the same year. The report's recommendations have been used to varying degrees to establish other codes such as those of the European Union, the United States, and the World Bank etc. For more information, see University of Cambridge (2014) *The Cadbury Archive*. Cambridge Judge Business School. [Online] available from: http://www.cadbury.jbs.cam.ac.uk/index.html. [Accessed: 29 July 2014].

[492] MacNeil, I. & Li X. (2006) "Comply or explain": Market discipline and non-compliance with the combined code. *Corporate Governance: An International Review*. Volume 14. Issue 5. 486-496. However, it was indicated that the above study examined rather unsystematically the contents of compliance statements dismissing them in a sweeping generalisation as unsuitable for providing reasoned explanations. For that, see Seidl et al. (2009) *'Applying "comply-or-explain": Market discipline…', supra* note 489.

shares regardless of whether they are incorporated in the UK or elsewhere. Since the CGRs rules need to be complied by all UK licensed entities, rules usually set out what is the minimum acceptable standard. There is no doubt that this is important to establish basic benchmarks of appropriate behavior, however, as it will be outlined later, this approach was criticised for contributing to worsening the corporate governance culture and for not encouraging companies to do more than the minimum.

As per the continuing obligations on the LSE, all companies with a Premium Listing of equity shares in the UK are required under the (UKLA) Listing Rules to report on how they have applied the Corporate Governance Code in their annual report and accounts.[493] As per the FCA's Disclosure and Transparency Rules (DTR)[494] an issuer must ensure that it:

- Monitors the financial reporting process.
- Monitor the effectiveness of the issuer's internal control, internal audit where applicable and risk management systems.
- Monitor the statutory audit of the annual and consolidated accounts.
- Review and monitor the independence of the statutory auditor.

The extent of a company's obligation to 'comply or explain' depends on the nature of the listing of that company's securities. Companies applying to admit securities to trading on the Main Market of the LSE must have their securities admitted to the UKLA Official List. The listing set out distinct listing obligations for specific security types and issuer types. Each category falls into one of two high-level 'segments,' Premium or Standard.

A Premium Listing is only available to equity shares issued by trading companies and by closed and open-ended investment entities. Standard Listings cover shares; global depositary receipts (GDRs), debt and securitised derivatives. In order to be eligible for the FTSE UK Index Series, which includes the FTSE 100 index, a company must have a Premium Listing. Companies with a Standard Listing must comply with EU minimum requirements on corporate governance disclosure, namely the Statutory Audit Directive[495] and the Company Reporting Directive.[496]

These directives were implemented in the UK through the DTR.[497] Companies with Premium Listed equity shares are subject to more stringent UK disclosure standards in addition to the EU minimum requirements. For this reason, companies that do not wish to comply with stringent conditions may choose to list on AIM. Shareholders are of course made aware that certain corporate governance matters are not required under such a regime

[493] Fsa.org.uk (2007) *LR 9.8 Annual financial report*. [Online] available from: http://fshandbook.info/FS/html/handbook/LR/9/8. [Accessed: 10 August 2014].
[494] The UK Disclosure Rules and Transparency Rules, *supra* note 329.
[495] Eur-lex.europa.eu (2014) *Directive 2006/43/EC on Statutory Audits of Annual Accounts and Consolidated Accounts, now amended by Directive 2014/56/EU of the European Parliament and of the Council of 16 April 2014*. [Online] available from: http://eur-lex.europa.eu. [Accessed: 3 March 2014].
[496] Eur-lex.europa.eu (2014) *Directive 2001/34/EC of the European Parliament and of the Council of 28 May 2001 on the Admission of Securities to Official Stock Exchange Listing and on Information to be Published on those Securities*. [Online] available from: http://eur-lex.europa.eu. [Accessed: 3 March 2014].
[497] The UK Disclosure Rules and Transparency Rules, *supra* note 329.

and will therefore have no voice (at legal) in the event that a company is not abiding by certain corporate governance matters.

There is no 'comply or explain' obligation on companies admitted to AIM. However, the LSE's 'A Guide to AIM' states that companies seeking admission to the AIM must publish an admission document that includes a statement on whether or not the company complies with its home country's corporate governance regime, and if not, an explanation as to why. The guide goes on to state that compliance with the Code by AIM companies is widely regarded as good practice and has become expected of larger AIM companies. Many investing institutions expect their investee AIM companies to comply with the Code or set out the reasons for non-compliance in much the same way as Main Market companies.[498]

Even though the corporate governance requirements are less stringent than a standard or premium listing on the LSE, AIM has taken precautions to ensure "accountability." In order to list on AIM, a company must appoint a "Nominated Advisor" often referred to as a "NOMAD."[499] A NOMAD is a financial adviser appointed by AIM to assist a company through the listing process on AIM. To be appointed as NOMAD the adviser must abide by strict condition which he must adhere to in order to remain a *bona fide* adviser on AIM.

This method of ensuring accountability as well as fostering AIM's reputation has proven quite beneficial. NOMADS are reluctant to advise companies to list on AIM that do not or cannot live up to the corporate governance requirements. Since a NOMADS "bread-and-butter" as it were depends upon ensuring that companies taken through an AIM floatation are reputable, it is unlikely that they will promote or support companies that do not measure up to the standards.[500] In preparing for admission to listing, a company is advised that the appointment of non-executive directors will add tremendous kudos to its admission. The issue of appointing non-executive directors to a board is crucial and is one of the conditions that NOMADS seek to ensure from their prospective clients. Non-executive directors are vital for impartiality and experience and are a key component of passing AIM's corporate governance requirements.[501]

Historically, Tadawul in KSA has relatively considered not very transparent simply because it was closed to international foreign investors. Technically speaking it still remains closed although nearby initiatives indicate that this may change. Over the years, KSA has implemented several rules and regulations to address the issue of corporate governance and in 1985 the MOCI approved the Disclosure and Transparency Standard. However, in 2006 the CMA Board issued the Corporate Governance Regulations in which it applies to listed companies. For that, corporate governance in KSA falls, somewhat confusingly, under the remit of both the MOCI and the CMA.[502] This confusion is problematic since external parties and investors are uncertain as to which body holds legal sway over corporate governance

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[498] The LSE Guide to AIM, *supra* note 31.
[499] *Ibid*., 10.
[500] *Ibid*., 14.
[501] *Ibid*., 19.
[502] The IMF (2012) *'Saudi Arabia: Reports on the observance of standards and codes*,' *supra* note 342 at 7, 10, 11.

issues. For example, the IMF review of KSA's implementation of IOSCO principles relating to corporate governance stated that key documentation issued by the CMA and the MOCI is in Arabic only and is, therefore, very difficult to understand.[503] There is a lack of clarity around the jurisdiction of the MOCI and the CMA especially with regard to corporate governance issues which are supposedly under the CMA, and as a result, it seems that some governance regulations would be difficult to enforce.

In KSA, both the CMA and Tadawul are tasked with building their credibility on the global and local stage in coordination with other important KSA Authorities. However, the CMA and SAMA need to work closely together in order to build awareness of the importance of corporate governance amongst companies, shareholders and stakeholders especially focusing on the development of director training programs and to disclose that in order to build qualified and ethically motivated directors.[504] Also compliance with certain existing non-financial disclosure requirements is considered to be weak by market participants in particular with respect to corporate governance-related information. Although companies are required to disclose in the board report their corporate objectives, their dividend policies, and the board composition, disclosure in other areas remains haphazard, in particular the disclosure of information related to beneficial ownership, board member qualifications, and nomination procedures.[505] Furthermore, the definition of independence is reasonably complete; however the assigned roles of an independent director should be specified.[506]

The above also applies to the UAECGRs of 2009.[507] Not only that banks and foreign listed companies are exempted from applying it. Moreover, banks being listed companies abide by the CBUAE guidance rules which resulted in confusion as well as the weakening of the SCA role as the primary regulator of the financial markets. The Red Flag Group,[508] conducted the 'Corporate Governance, Compliance and Code of Conduct Study 2013,' on the UAE listed companies. With transparency as the essence of the report, it provided a detailed insight into the publicised approaches to corporate governance and compliance. Each was judged on eight criteria, including whether they had a publically available code of conduct, a whistle-blower policy and if they have a designated and experienced chief compliance officer. All of these factors were analysed and companies were scored out of a possible, perfect score of 32.0. The sample group of the study was comprised of companies listed on the DFM and ADX. Company statistics were gathered and each of the companies was subsequently ranked from largest to smallest in terms of market capitalisation.

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[503] *Ibid*., 12.
[504] Al-Janadi, et al. (2012) *'The level of voluntary disclosure practices…'*, *supra* note 340.
[505] Worldbank.org (2009) *'Saudi Arabia: Corporate Governance Country Assessment*…,'*supra* note 345, at 5.
[506] *Ibid*.
[507] The SCA Resolution of 2009 Concerning Governance Rules, *supra* note 295. Generally, see Abdel Moniem (2014) *'Corporate Governance in the UAE Legislation*', *supra* note 297, at 164-65.
[508] A global professional services firm in the areas of governance and compliance. See Redflaggroup.com (2013) *'Corporate Governance, Compliance and Code of Conduct Study 2013',(The 3 C'S Report)*. [Online] available from: https://www.redflaggroup.com/newsroom/uae-companies-fail-see-importance-compliance-and-risk-transparency-report-reveals. [Accessed: 29 May 2014].

The study is divided into two parts with a detailed set of criteria under each; (a) Analysis of overall approaches to corporate governance and compliance. (b) Analysis of publically-available codes of conduct. The study revealed the following:

1. The average score for companies from the UAE is a mere 5.5 out of 32.0. London and Singapore outperformed the region with higher average scores of 12.6 and 18.2. The study indicated that the UAE companies had not fully complied with the Corporate Governance Code of 2009. While the companies appointed Compliance Officers, they were not very senior, lacked clarity on their roles and responsibilities, and for some of them compliance was all about ticking the boxes.
2. Only 9 of the 123 companies make their codes of conduct publically available, which demonstrates a significant lack of transparency and best practices in the area of compliance – thus, exposing most UAE companies to risk.
3. Most sectors score similarly between Dubai and Abu Dhabi, but there are notable differences within a few, with the latter scoring significantly higher in the consumer products and engineering sectors; and the former scoring notably higher in the telecommunications, transportation and banking sectors.[509]

The report also revealed that some analysts indicated that companies which remain under the direct control of a strong chairman struggle to set up independent risk management mechanisms. As global banks reduced staff count amidst low business some years ago, domestic markets, dominated by retail investors, have seen a reduction in the number of company analysts publishing corporate reports. This trend is reversing now. However, with the upgrade of the UAE markets to emerging market status by major international Index providers like MSCI,[510] large foreign financial institutions and investment funds are now investing in UAE listed companies, which is leading to the strengthening of the Corporate Governance culture in the UAE based companies. More corporate scandals over the recent past have come to light in the more stringently regulated world of the DIFC. Some of the incidents include the misuse of funds by the owners of Dubai jeweler Damas,[511] Shuaa Capital's fine [512] for alleged market manipulation on Nasdaq Dubai.

The report further makes out a case for companies seeking global capital stating that they should display a commitment to higher corporate governance standards, use compliance as a competitive advantage and build ethics into their corporate culture as something which has great tangible value. The UAE companies are now implementing a robust compliance culture with greater seriousness, the report states; thereby becoming more proactive and less reactive in responding to regulatory issues. Other business intelligence firms also say demand

[509] *Ibid*.
[510] MSCI Market Classification, *supra* note 79.
[511] DFSA v Damas 2010. Dfsa.ae (2010) *Enforceable Undertaking - Damas International Limited - The Abdullah Brothers*. March 2010. [Online] available from: http://www.dfsa.ae/Documents/Enforceable%20 Undertakings%202010/Abdullah%20Brothers%20EU.pdf. [Accessed: 3 October 2014].
[512] DFSA v Shuaa Capital International Limited 2008. Dfsa.ae (2008) *Enforceable Undertaking - Shuaa Capital*. September 2008. [Online] available from: http://www.dfsa.ae/Documents/EU%20-%20Shuaa%20 Capital%20-%20September%202008.pdf. [Accessed: 3 October 2014].

for background checks on potential partners and suppliers in the Middle East have risen since the global financial crisis.[513]

Overall, the corporate governance compliance in the UAE is mandatory while in the UK and KSA, is designed to provide flexibility so that a company may achieve the outcome intended by the principles whilst taking into account the nature, scale and complexity of its business. Notably, there are also differing requirements between the related jurisdictions, such as the number of independent directors on a board. While the UK Code requires that at least half the board, should comprise independent directors, and that smaller company should have at least two independent directors. The UAECGRs require that at least one third of the directors be independent. In KSA two board members or at least one-third of the board (whichever is greater in number) should be independent[514]

## 6.7 Conclusion

This Chapter indicates that KSA and the UAE regulatory systems have shortfalls in the areas of systemic risk management, the lack of institutional investors within the markets, shortages of investor confidence, insider dealing, fraud and malpractice within the securities markets, false accounting, and problems relating to corporate governance. It seems that regulations as well as enforcement need to be improved as the current regulations do not appear to constitute an efficient system which will deter insider dealing and enforce issuers to make timely disclosure.

Based on the history of financial markets, it is also assumed, that rigorous regulation is the main method in maintaining an informative, transparent and efficient market. With regards to the deficits in the rules relating to the above, the final chapter will examine the attempts and possible approaches and methods aimed at providing a solution to these problems.

The next chapter will analyse sound practices in the UK along with academic and practitioners works and publications to build the case to offer a set of suggested solutions to the afore mentioned endemic problems.

[513] See *ibid*; and Kerr, S. (2013) UAE corporate governance falls short. *Financial Times*. 15 April 2013. [Online] available from: http://www.ft.com/intl/cms/s/0/53b79214-a5ab-11e2-9b77-00144 feabdc0.html#axzz3 crxIRdLe. [Accessed: 26 December 2014].

[514] Section B.1.2 of UK's Code, *supra* note 488, Article 12(e) of KSA CGRs, *supra* note 231, and Article 3(2) of the UAE CGRs, *supra* note 295. However, KSA CGRs do not assign specific responsibilities or board committee memberships to the independent directors, and ultimately leaves it up to the company articles of association to define how independent directors will contribute to the effective roll out and completion of board task. See Worldbank.org (2009) *'Saudi Arabia: Corporate Governance Country Assessment*…,' *supra* note 345.

## Chapter Seven

## Suggested Approaches to Selected Problems Common To the Securities Markets of the United Kingdom, Kingdom of Saudi Arabia And the United Arab Emirates

As seen from the previous Chapter, KSA and the UAE need their respective stock markets to better allocate their investments. Instances of past stock markets liberalisations in many countries have proven to enhance investment by lowering the cost of capital that arises from revaluation of stock prices.[515] In this sense, stock market development will effectively complement the financial services provided by the bank-based financial system. To obtain this desired outcome, liberalisation has to be accompanied by the requisite legal and regulatory reforms that enhance the institutional environment for investors as the absence of these reforms denies the stock market from having great impact on investment. Emphasis then should be on stock market developments with the appropriate institutional infrastructures, because not only that could increase investment but, perhaps more importantly, its efficiency too.[516] The following Chapter therefore puts forward various solutions for the problems examined previously.

### 7.1 Suggested Approaches to Disclosure & Transparency.

At the heart of disclosure and transparency issues is the equitable distribution of information. Properly informed members of public are able to make informed financial decisions. A company accused of non-disclosure and ambiguity will not garner high investor confidence and it is likely that this will be reflected in its share price.[517] Successful global equity markets all share key characteristics, foremost of which is that they are all considered to be transparent and fair. Proponents argue that transparency makes capital markets accessible to both retail and institutional clients, enhances market integrity and stability, and provides regulators greater ability to monitor activity. They reason that with the introduction of transparency, price discovery and the bargaining power of previously uninformed participants improves. Thus, a new or uninformed investor is able to access the same type of information as an investor who has been vested in the market for some time. Timely and equitable dissemination of information is the crux of the matter.[518]

A transparent market also disseminates timely post-trade information. In today's fast paced and interconnected world it would seem very strange indeed if investors were unable to access corporate, price and trading information of any given listed stock but instead had to rely on a limited set of options including telephone calls with broker dealers or consultations

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[515] Henry, P. B. (2003) Capital-account liberalization, the cost of capital, and economic growth. *American Economic Review*. Volume 93. Issue 2.

[516] See Bekaert, et al. (2005) *'Does financial liberalization spur growth', supra* note16; and Bolbola & Omran (2005) *'Investment and the stock market: evidence…', supra* note 307.

[517] See Dixon, R. & Holmes, P. (1991) *Financial Markets: An Introduction*. London: Chapman and Hall; and Jirasakuldech, et al. (2011) *'Financial disclosure, investor protection…', supra* note 318.

[518] Fox, et al. (2003) *'Law, Share Price Accuracy, and Economic…', supra* note 117.

with other third party specialist who would provide such information for a fee. For example, in the US, the debt and corporate bond markets underwent significant changes in July 2002. Information on prices and volumes of completed transactions were required to be (once again) publicly disclosed. It was primarily through the efforts of the National Association of Securities Dealers (NASD),[519] now FINRA, that post trade data was collated via the Trade Reporting and Compliance Engine (TRACE) program.[520]

Similarly, in the UK and as per both the MiFID and the FCA regulation, all EU regulated market securities (including all the UK securities) are supported by a pan-European trade reporting service.[521] The provision of detailed and pertinent information to investors reached it ascendency in the UK in 2007 with the conclusion of what the EU referred to as the Transparency Directive which took effect in the UK on 20 January 2007.[522] This Directive details the EU's requirements on transparency in relation to information about issuers who are listed on regulated markets. It created a framework for companies across Europe to adopt similar standards around information disclosure. The Directive requires companies to disclose information at regular intervals through specific channels and, in that way, it bears many similarities to the existing UK regime.

In essence, the Transparency Directive covers the content and regularity with which companies should report financial information and the way in which these information should be relayed to the market. It should be noted that the new Transparency Directive that was issued in 2013 closes an existing gap in the notification requirements by requiring disclosure of major holdings of all financial instruments that could be used to acquire economic interest in listed companies. A second major change is the fact that the requirement to publish quarterly financial information was abolished. This aims at reducing the administrative burden and encouraging long term investment. Finally country-by-country reporting disclosure requirements have been incorporated in the new Transparency Directive.

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[519] Finra.org (2014) *Financial Industry Regulatory Authority*. [Online] available from: http://www. Finra.org. [Accessed: 22 June 2014]. For more information on FINRA efforts, see Asquith, P., Covert, T. & Pathak, P. (2013) The Effects of Mandatory Transparency in Financial Market Design: Evidence from the Corporate Bond Market. *National Bureau of Economic Research, Inc*. Cambridge. Working Paper No. 19417. [Online] available from: http://economics.mit.edu/files/9018. [Accessed: 13 September 2014].

[520] TRACE is the FINRA developed vehicle that facilitates the mandatory reporting of over the counter secondary market transactions in eligible fixed income securities. All broker/dealers who are FINRA member firms have an obligation to report transactions in corporate bonds to TRACE under an SEC approved set of rules. Current TRACE reporting time: 15 minutes. For more information, see Finra.org (2014) *Trade Reporting and Compliance Engine (TRACE)*. [Online] available from: http://www.finra.org/Industry/Compliance/Market Transparency/TRACE/. [Accessed: 22 June 2014].

[521] Londonstockexchange.com (2014) *Trading Services*. [Online] available from: http://www.londonstock exchange.com/products-and-services/trading-services/european-trade-reporting-service/european-trade-reporting-service.htm. [Accessed: 2 May 2014].

[522] The above Directive was amended many times and last amendment took place in 2013. See Eur-lex.europa.eu (2014) *Directive 2013/50/EU of the European Parliament and of the Council of 22 October 2013 amending Directive 2004/109/EC of the European Parliament and of the Council on the harmonisation of transparency requirements in relation to information about issuers whose securities are admitted to trading on a regulated market, Directive 2003/71/EC of the European Parliament and of the Council on the prospectus to be published when securities are offered to the public or admitted to trading and Commission Directive 2007/14/EC laying down detailed rules for the implementation of certain provisions of Directive 2004/109/EC*. [Online] available from: http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:L:2013:294:0013:0027: EN:PDF. [Accessed: 22 June 2014].

Companies are also obliged to disclose regulated information on a fast and a web portal serving as a European electronic access point. Companies already use regulatory information services, such as RNS,[523] to disseminate information widely and speedily.

On a stock exchange as prestigious as London, it is imperative that investors have no doubt in their minds that corporate and financial information will be released in a timely and efficient manner. Furthermore, the content of this information must be detailed and pertinent and investors need to be certain that the authorities (in this case the FCA and the UKLA) have vetted all the said information to ascertain its veracity. As a result, investors have high confidence in the UK's financial authorities as well as the LSE. In fact, the LSE is one of the world's most respected exchanges and companies listed on it must subscribe to a stringent set of admission and disclosure standards ensuring high quality and simultaneously providing deep pools of capital.[524]

The UK financial Authorities are constantly examining ways to improve dissemination of information. The FCA's DTR[525] are regularly adapting to changes in the financial and regulatory environment. These rules cover corporate governance; disclosure and control of inside information by issuers, transactions discharged by senior employees of the issuers as well as connected persons, financial reporting and its associated requirements, voting right issues and continuing obligations in order to remain in compliance with a London listing.[526]

Investors, stakeholders, issuers, and other related third parties are invited to discuss and make suggestions regarding rules and regulations and in this manner they are constantly adapting to the financial regime. It is through regular discussions and panel participation that all stakeholders are able to come to some form of agreement as to what is best for all concerned. Furthermore, the FCA's prospectus rules outline in detail what firms must disclose thus adding to the significant transparency and disclosure requirements.[527]

The UK's approach in ameliorating disclosure and transparency is, in the researcher's opinion, significantly pre-emptive. In other words, lessons learnt from the carnage of the financial crisis include taking action before an event takes place. It is therefore pro-active

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[523] RNS is both a regulatory and financial communications channel for companies to communicate with the professional investor. RNS is the UK’s leading service for regulatory news announcements. The provider of choice for companies traded on the London Stock Exchange, RNS helps companies and their intermediaries fulfill their UK and other global regulatory disclosure obligations in the most efficient way possible.Approaching 250,000 announcements are processed by RNS each year, with over 70% of all regulatory and potentially price-sensitive UK company announcements originating from RNS. Clients include the vast majority of Britain's leading benchmark companies as well as all the leading financial public relations firms and corporate advisers. See Londonstockexchange.com (2014) *Regulatory News Service (RNS)*. [Online] available from: http://www.londonstockexchange.com/products-and-services/rns/about/rns-remove.htm. [Accessed: 30 December 2014].

[524] Londonstockexchange.com (2014) *Listing Regime and Obligations*. [Online] available from: http://www.lseg.com/areas-expertise/our-markets/london-stock-exchange/equities-markets/raising-equity-finance/main-market/listing-regime-and-obligations. [Accessed: 22 July 2014]

[525] The UK Disclosure Rules and Transparency Rules, *supra* note 329.

[526] *Ibid*.

[527] Fca.org.uk (2014) *FCA Prospectus Rules (PR)*. [Online] available from: http://fshandbook.info/FS/html/FCA/PR. [Accessed: 22 June 2014].

rather than passive. For example, the FCA regularly involves itself in what it refers to as "feedback" sessions. The outcome of discussions, views, opinions, and suggestions of stakeholders are formulated and published in order to achieve some form of all round consensus on matter being discussed.[528]

The FCA takes its own transparency very seriously too and it is this key issue that, in the researcher's opinion, differentiates itself from both KSA and the UAE regulators. The open forum for discussion and the FCA's willingness to ensure that its own procedures are transparent to all other stakeholders who include firms in the market, business operators and other third parties cements the investor confidence in the UK equity markets. Are their open forums to discuss the transparency of the Saudi Capital Market Authority? Or the Emirates Securities and Commodities Authority?

Government laws and regulations ensure transparency and disclosure requirements are diligently followed through. In the UK, the authorities are not at all shy in imposing penalties on those who do not abide by the rules. The FCA Fines Tables for 2014[529] is a key reminder of just how often the FCA punishes transgressors. The fines levied for 2013 and published in March 2014 are a staggering UK£86 million![530] Notably, the Spanish bank, Santander contributed the amount of UK£12 million[531] to this total by explicitly misleading consumers and not adhering to correct transparency rules and it is precisely this commitment to the law and transparency that sets the UK financial markets apart. No one, no matter who they are, can get away with breaking the rules within London's stringent equity capital markets. Now, conversely, let us examine the solutions to the weakness of transparency and disclosure in KSA and the UAE, as noted in the previous Chapter.

The Morgan Stanley Consumer Index (MSCI)[532] classifies the UK as a developed market. It also classifies KSA as a 'standalone' market and the UAE as 'emerging' (up from frontier in 2013).[533] The MSCI index alone is sufficient evidence to measure a nation's adherence to transparency. KSA's 'standalone' ranking informs investors that transparency and disclosure issues are significantly lacking whereas the UAE's ranking of 'emerging' suggests the exact opposite. An emerging market, at least in MSCI's opinion, has taken significant steps towards positively addressing matters of transparency. Similarly, an emerging market status also indicates that financial authorities have worked hard at

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[528] Fca.org.uk (2014) *FS13/1: Transparency - Feedback on DP13/1*. [Online] available from: http://www.fca.org.uk/your-fca/documents/feedback-statements/fs131. [Accessed: 22 June 2014].

[529] Every year, the FCA announces on its website the names of licensed individuals and firms that have breaches transparency, market abuse and/or disclosure requirements. They are then named and shamed publicly with the fine levied clearly displayed. For that see Fca.org.uk (2014) 2013, 2014 & 2015 Fines. [Online] available from: http://www.fca.org.uk/firms/being-regulated/enforcement/fines. [Accessed: 23 June 2014]. For the table of fines of previous years, see Fsa.gov.uk (2014) *Fines table 2002–2013*. [Online] available from: http://www.fsa.gov.uk/about/press/facts/fines. [Accessed: 23 June 2014].

[530] *Ibid*.

[531] *Ibid*.

[532] See Morgan Stanley Capital International, *supra* note 8.

[533] MSCI Market Classification, *supra* note 79; and MSCI to Reintroduce Indices for Saudi Arabia, *supra* note 336.

improving and retaining investor confidence and that they are committed to doing whatever is necessary to further this cause.

The KSA CMA and the UAE SCA lays down the rules and regulations for transparency and disclosure in their respected jurisdictions. As noted previously, transparency and disclosure issues are closely related to MSCI's 'standalone' ranking. Openness to foreign ownership is a matter of controversy and this fact alone has often stood in the way of international investor's negative perception of the country. Are the rules poor or is it the imposition of the rules by the market regulator that are deficient? One would suggest that the actual rules for transparency and disclosure are sufficient but here is a general lack of follow through when it comes to enforcement.

There is no doubt that a plethora of regulations have been passed including investment fund regulations, market code of conduct as well corporate governance which have indeed provided a clearer framework for companies and individuals to use.[534] However, it is the application of these rules that has given cause for concern. Disclosure and transparency in enforcement also appear to be an issue as there is no point in having detailed regulations if there is no one to enforce these rules. Enforcement penalties are not exercised equally across all the listed entities with the result that the two regulators have been unable to demonstrate a balanced, consistent and equitable track record in their regulatory actions.[535]

As mentioned before, rules mean nothing without strong policing. The current disclosure and transparency rules with regard to all corporate governance issues, particularly with respect to disclosure of information related to beneficial ownership, board of director qualifications and nominations procedures still remain haphazard and unreliable.[536] However, Tadawul has attempted to correct this key concern by undertaking an initiative to publish ownership data online as well as publishing the violators names. Clearly, the CMA and Tadawul need to continue to develop the process to ensure that company disclosure is in compliance with applicable rules and it should also enforce disclosure of compliance equally across all offending entities without exception.

This 'naming and shaming' approach is similar to the FCA's regime and clearly has benefits towards improving transparency in the country. Ensuring that violators are named and shamed is certainly not an easy matter, in KSA and the UAE, where business and social affairs are usually kept secret. There is a deep cultural aversion towards airing faults and displaying violations in public and it is this cultural variation that leads to such disparity in investor perception. This must be changed. A financial regime that allows the breach of law is inefficient and impractical and will only serve to damage the reputation of the market in the long run.

Not only such high level of disclosure and transparency appears in the UK stock markets, but it also appears in the debt market. The LSE Professional Securities Market

[534] The SCA Regulations as to Disclosure and Transparency, *supra* note 275.
[535] See Chapter six for more details.
[536] *Ibid*.

(PSM) [537] specialises in the listing of all types of debt including corporate debt, Eurobonds, ABS's [538] and convertibles. A redeeming characteristic of this market is that debt can be listed in practically any denomination that the issuer wishes. The PSM has stringent disclosure and transparency regulations that all issuers are required to adhere to. Both the FCA and LSE's commitment to transparency are maintained in the PSM.

What makes London's capital market much more superior to most other global markets is the variety of choice and depth available. The development of a huge secondary market in debt, fixed income and bond trading is staggering. The PSM provides a more flexible alternative to the requirements regarding denomination and financial information compared to other markets regulated in the context of the EU directives, and it is aimed at issuers targeting professional investors. There are currently more than 550 [539] debt securities admitted to this market.

On the PSM, debt securities, regardless of the denomination, can be admitted under a wholesale regime. By following this route to listing, companies are able to admit any type of debt security. There are a wide range of benefits for issuers, including a less onerous listing process; the ability to submit listing particulars as defined in Chapter 4 of the UKLA's Listing Rules;[540] also, issuers do not need to submit accounts according to International Financial Reporting Standards (IFRS); instead, local GAAP suffices. Clearly the rules are less stringent than a premium listing on the primary market. Admission and disclosure standards [541] are certainly less onerous than the primary market but are no less exacting. Companies seeking to list debt on the PSM must still disclose key financial information, as well as (when required) a prospectus which will be subject to the rules of the competent EU home regulator. Similarly, issuers wishing to transfer from London's main market to the PSM are required to follow correct procedure such as make the appropriate announcements through the 'Regulated Information Service' (RIS) stating the issuers intent to move.[542] Such clarity of information by issuers to the public serves to highlights London's commitment to transparency and disclosure.

Needless to say, continuing obligations on the PSM ensure that continuous price sensitive information is provided to investors and market participants. The Exchange has a responsibility to ensure that it operates proper and orderly markets. In order to achieve this, it is essential that companies publish price-sensitive information on a timely basis and in

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537 Londonstockexchange.com (2014) *Professional Securities Market*. [Online] available from: http://www.londonstockexchange.com/companies-and-advisors/psm/home/psm.htm. [Accessed: 24 June 2014].
538 ABS – Asset backed securities (Collateralised Debt Obligations or CDO's). See Investopedia.com (2014) *Asset-Backed Securities (ABS)*. [Online] available from: http://www.investopedia.com/exam-guide/cfa-level-1/fixed-income-investments/abs-asset-backed-security.asp. [Accessed: 24 June 2014].
539 Londonstockexchange.com (2014) *Rules and Regulations for Debt*. [Online] available from: http://www.londonstockexchange.com/specialist-issuers/debts-bonds/rules-regulations/rules-regulations.htm. [Accessed: 24 June 2014].
540 The LSE Listing Regime and Obligations, *supra* note 524.
541 Londonstockexchange.com (2014) *Admission and Disclosure Standards*. [Online] available from: http://www.londonstockexchange.com/companies-and-advisors/mainmarket/documents/brochures/admission-and-disclosure-standards.pdf. [Accessed: 24 June 2014].
542 *Ibid*.

accordance with the rules of their securities regulator, which impose a general obligation on companies whose securities are admitted to trading on a regulated market or prescribed market to release information of this type. The timely publication of information benefits companies by allowing the market in their securities to function properly and benefits investors by ensuring that all participants are operating on an equal basis.

The standards relating to disclosure of information to the Exchange are outlined in 'Continuing Obligations,'[543] and include a requirement for an issuer to inform the Exchange of the timetable for any corporate action affecting the rights of existing shareholders. It is vital that compliance with the standards is enforced for the benefit of all companies and the market as a whole. Compliance with the standards is important to ensure that the exchange continues to operate high-quality and orderly markets and that there is suitable protection for all market participants, including companies and investors. As far as possible, when a breach is detected, action is taken on a timely basis.

The Order book for Retail Bonds (ORB)[544] offers electronic trading in gilts and retail-size corporate bonds, i.e. those which are tradable in smaller, more manageable denominations of UK£1,000 or similar. These include some of the UK's most well-known companies such as Vodafone, GlaxoSmithKline, BT and Marks & Spencer. It also provides corporate issuers with an efficient mechanism for distributing bonds to private investors – helping to stimulate new issues of bonds that are tradable in smaller denominations and providing private investors with wider investment opportunities. The new order book brings transparency to the bond market in three ways: all participants simultaneously access executable prices and have equal opportunity to trade at the best available price; can see the price discovery process through data feeds; and all trading is monitored by experienced market surveillance teams and the regulator.

What makes a secondary market transparent? There are many questions to ask in this regard. Is the current level of transparency optimal? Or should it be raised? Will such a change emerge spontaneously from market forces, or is regulatory intervention necessary? There are at least two types of transparency. Markets are ex-ante (or pre-trade) transparent when investors have access to quote information before trading. Ex-post (or post-trade) transparency refers to the dissemination of information about trades to market participants (after the trade). These broad categories themselves must be refined. For example, ex-ante transparency is greater if the observable quotes are firm, or if the identity of the agent posting the quote is known, or if all orders are visible (as opposed to hidden). No doubt the greater the population of investors observing ex-ante quotes or ex-post-trades information, the greater the level of transparency. So there appear to be several forms of pre-trade transparency. Do investors request that before trading at a price, this price should be announced to all market participants? In that case, are investors required to announce the size

[543] Fca.org.uk (2014) *FCA/LR/4 Listing particulars for professional securities market and certain other securities*. [Online] available from: http://fshandbook.info/FS/html/FCA/LR/4. [Accessed: 24 June 2014].
[544] Londonstockexchange.com (2014) *Welcome to ORB London Stock Exchange's Order book for Retail Bonds*. [Online] available from: http://www.londonstockexchange.com/traders-and-brokers/security-types/retailbonds/orb-overview1.pdf. [Accessed: 24 June 2014].

of the deal and the participants in the trade? If someone has a better offer, would they be allowed to step in?

Similarly, there are several degrees of post-trade transparency, depending on a number of variables. What is reported? – Just the transaction price (or rather the yield spread relative to Treasury)? What about the quantity traded? Is there at least an indication of the size of the trade, e.g., below 500,000, or above one million? Should the direction of the trade also be reported? And with what delay should the information be disseminated?

Clearly, there are other instruments other than bonds that contribute to London's pre-eminent position in global secondary markets including warrants and OTC derivatives. Transparency drives this desire to constantly grow the second market in the UK. It is the transparency that investors crave that makes London such a special place. On a further note, the LSE is constantly adapting to global investor demand and appetite and has recognised the world's vast hunger for investing in corporate debt markets. In a nod to this hunger, the LSE is one of a number of major stock exchanges looking to build its bond-trading activity.

Recently, the LSE agreed a US$15 million deal to buy Bonds.com, a platform for US corporate and emerging market bonds.[545] The growth of the secondary bond market is a reflection, in the researchers' opinion, of the importance transparency is awarded in the UK capital markets. Had the effort and focus on disclosure and transparency not been as aggressive or as all-consuming then it is doubtful that the bond market would have grown to such an extent. In a way, one of the ways that London seems to ameliorate transparency is not just by passing rules and ensuring strict enforcement but also by actively investing (purchasing) in secondary market platforms that will help further expand London's supremacy over the global bond markets.

Juxtaposed to the vast size that is the UK's bond market, we turn now to the practically non-existent secondary markets (for bonds and other structured products) in the UAE and KSA. How can such a vast difference exist? Surely the complete lack of secondary markets in either the UAE or KSA would indicate weak primary market activity?. Weak primary market activity is certainly the case especially post financial crisis. Listings and IPO's have been few and far between. Volumes on the markets have been poor up until now. It is only recently (2013 and after) that the UAE equity capital markets have begun to soar again.[546] The growth of volume on the exchanges in the GCC in general has not been accompanied by a growth in the secondary markets.

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[545] Financialnews.com (2014) *UK equities volumes surge at LSE, March 2014*. [Online] available from: http://www.efinancialnews.com/story/2014-03-27/lse-reports-strong-start-to-the-year-for-uk-equities. [Accessed: 24 June 2014].

[546] Al Sayegh, H. (2014) *Dubai stock market index passes 4,000 for first time since 2008*. February 2014. [Online] available from: http://www.thenational.ae/business/industry-insights/markets/dubai-stock-market-index-passes-4-000-for-first-time-since-2008. [Accessed: 25 July 2014].

An efficient secondary market does not exist in KSA even though Tadawul is the largest (by volume turnover) Arab stock exchange.[547] The existence of efficient secondary markets for government securities, debt and other financial instruments barely exist in KSA even though Tadawul launched a secondary platform for the trading of sukuk in 2009. However, turnover was so low and trading so thin that this can hardly be called an efficient secondary market. The country suffers from a weak secondary market which is a reflection of a narrow investor base, a short-term investment culture and the absence of investment banks and large foreign institutional investors. Due to a lack of a liquid secondary market, portfolio and fund managers are also reluctant to invest. The market also lacks fixed income institutional investors and investment funds that usually play an important role in secondary market trading.[548]

Clearly, the outlook is not as rosy as one would have imagined. There does appear to be hope and the KSA Authorities have suggested that one of the ways that they can begin to ameliorate disclosure and transparency issues is to allow foreign investors to actively and directly invest in KSA equity markets. Clearly, introduction of foreigners into the market will not directly improve transparency and disclosure but will certainly help persuade market participants that if foreign capital is to remain in the country then serious transparency and disclosure measures will have to be taken.

KSA nationals have generally represented the majority of investors on Tadawul. Needless to say, this isolation from the rest of the world has not caused negative liquidity problems in the country. On the contrary, KSA Tadawul is the largest Arab stock exchange in the world with an annual value of shares traded in 2011 of SR 1.09 trillion and SR 1.92 trillion in 2012. [549] The current limitations for foreigners trading on the exchange have been a function of KSA's isolation to the rest of the world, a fact which, in hind sight, is liable to keep trillions of US dollars away from the ever growing KSA market. Traditionally, since no foreigners were permitted to trade they could, as of 1999, invest in Tadawul by purchasing and sale of government approved mutual funds. Currently the standard swap agreement has replaced the mutual fund investment. Today, swap agreements allow an authorised local firm to trade on behalf of the foreign investor.

In January 2014, the CMA reported that it is finalising a regulatory framework which will allow foreign investors to directly own stocks without the need for swap agreements.[550] Due to the size of KSA market, foreign appetite is strong and authorities are keen to deepen the market and improve transparency as well as gradually build investor confidence in the

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[547] Marketwatch.com (2014) *Will the Saudi market finally open to the West*?. January 2014. [Online] available from: http://www.marketwatch.com/story/will-the-saudi-market-finally-open-to-the-west-2014-01-15. [Accessed: 24 June 2014].

[548] See McKinsey & Company (2005) *'Developing and Integrating GCC Capital Markets…'*, *supra* note 44, at 82-83; and Althanyan, F. (2011) *Demands for the Entrance of the Foreign Investor in the Saudi Stock Market*. 19 December 2011. [Online] available from: http://www.alriyadh.com/2011/12/19/article693014.html. [Arabic]. [Accessed: 26 July 2014].

[549] Tadawul.com.sa (2012) *Tadawul – Annual Statistical Report – 2012*. [Online] available from: http://www.tadawul.com.sa/static/pages/en/Publication/PDF/Annual_Report_2012_EN.pdf. [Accessed: 27 June 2014].

[550] Draft Rules for Qualifies Foreign Financial Institutions Investment in Listed Shares, *supra* note 213.

Saudi capital market. If this regulation is approved then the change to KSA financial landscape will be significant.

In a similar vein to KSA, the UAE has yet to develop an efficient secondary market for bonds, sukuk or any other financial instrument including derivatives. Indeed, regulation is in place for the issuance of listed debt and bonds as well as Islamic sukuk and yet the market has never really taken off like it has in Malaysia or Singapore. There is no doubt that the UAE should develop a bond market to open a new investment channel for banks to tap their liquidity following a period of stagnation in lending because of the global fiscal crisis and indeed any other future financial meltdown. The lack of diversity in financial instruments will serve to hamper future development of the UAE equity capital markets. The Financial regulator, the SCA, is also working on a number of new rules that, is believed, will develop the markets further including regulations for 'covered bonds' as well as "Trading of Stocks of Private Companies" otherwise called the "Second Market." The development of secondary markets must be attractive to issuers, provide financial development and growth as well as support local employment.

On deeper examination, in order for the second markets to be efficient in KSA and the UAE, the government intervention would be needed to boost such market as well aligning with the powerful commercial banks in the two countries. In either case, authorities have come to accept that the development of the market for government securities as well as conventional bonds is vital for the overall development of the markets.[551] Indeed the secondary market for government securities may act as a catalyst for wider fixed income securities markets development. As secondary markets develop, transaction costs are lowered and liquidity increases, so investors gain the confidence needed to invest in long-term government securities. The recent announcement by the Prime Minister of the UAE Sheikh Mohammed Bin Rashid establishing Dubai as a global Islamic finance hub[552] over the next few years is a stepping stone towards the establishment of secondary market trading platforms. The strong governmental interest on the development of the Islamic sector will contribute significantly to the development of the Islamic sukuk market. However, although the UAE has had a history of issuing sukuk, an active trading market is still under developed. Now that the UAE has been officially upgraded to emerging status by MSCI there is no longer any excuse to remain on the sidelines. In order to ensure transparency as well as keep foreign investors interested, the UAE will have to simultaneously develop the secondary market whilst keeping a close eye on matters of transparency as well as ensuring that punitive measures and penalties are carried out to the letter in the event of a breach.

A financial regulator must be empowered to penalise violators in order to send a strong message to the market. It is hoped that financial regulators in the future will be more prone to issuing punishments for violations. Both the UAE and KSA capital market

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[551] Sca.gov.ae (2014) *SCA holds road shows to highlight bonds and sukuk*. [Online] available from: http://www.sca.gov.ae/English/news/Pages/17-09-2014.aspx. [Accessed: 25 September 2014].

[552] Gulfnew.com (2013) *Dubai races to become global Islamic finance hub*. November 2013. [Online] available from: http://gulfnews.com/business/sectors/banking/dubai-races-to-become-global-islamic-finance-hub-1.1258076. [Accessed: 1 June 2014].

Authorities must be seen to penalise offenders at a higher rate since currently, in the view of the researcher, there is a perception in the market that offences, especially some forms of market abuse, can be committed with impunity. Transparency and market confidence suffer immeasurable damage when market participants see that offenders are not punished and will contribute towards the lack of international investors. When transparency is not guaranteed and punishment of violators depends on who the perpetrators are or aren't, then it is unlikely that investors will take a positive view of transparency in the country.

However, one must give credit to the UAE financial Authority which has certainly worked diligently with all other parties to ensure that transparency (especially post financial crisis) has vastly improved. The SCA has issued a revised version of regulations related to the issuance of debt as well as Islamic Sukuk instruments [553] which aimed to lay a firm foundation for the development of the secondary markets in the UAE. Furthermore, the SCA has only recently passed and approved several other regulations which, it is hoped, will add to the overall volume of trading on the UAE's exchanges. Regulations on warrants, covered bonds, short selling, market making and securities borrowing and lending were all issued in the last two years. By attracting greater numbers of foreign investors the SCA will also have to focus more of its attention of the disclosure and transparency needs of investors and companies under a more complex market structure where a combination of financial instruments (other than just equities) are used in the market place.

The DFM operates an order driven system whereby buying and selling orders are automatically matched on a first come first served basis. Both local and international investors can place buy/sell orders via DFM approved brokers who then place the orders in the automated trading system. As the GCC's only listed stock exchange, the DFM holds a unique position within the Arab world. Having been listed just at the beginning of the financial crisis, the DFM stock experienced significant downturns throughout the financial crisis and has only recently swung to a third-quarter net profit as a result of higher trading volumes, improved stock prices and a more bullish investor sentiment as a result of the improved economic climate.

As one would expect, improved trading volumes has come hand in hand with increased local and international investor confidence which has, no doubt, increased the pressure on the UAE capital markets to improve matters of transparency, an issue that the SCA has taken very seriously indeed. There is no doubt that the re-classification of the UAE's equity capital markets by the MSCI from frontier to emerging is a direct reflection of the improvement efforts done by the UAE financial regulators; the SCA, and other government bodies over the last three years. An upgrade of this type indicates increased investor confidence in transparency and disclosure. For example, in the MSCI Global Market Accessibility Review, June 2013 several key issues were highlighted including the matter of

[553] Sca.gov.ae (2014) *SCA board approves regulations for sukuk and corporate bonds.* April 2014. [Online] available from: http://www.sca.gov.ae/English/news/Pages/26-04-2014.aspx. [Accessed: 25 September 2014].

equal rights to foreign investors and the perception by international players that foreign investors are limited as a result of the stringent foreign ownership limits.[554]

Indeed, there have been instances where transparency has been in the lowest level. In the first two months of 2012, one of the UAE's largest listed construction companies, Arabtec had its share price increase 128% on unsubstantiated rumours. Shares price escalation was so serious that trading had to be temporarily stopped and an investigation ensued. Speculation was rife in the market and investors believed that the company was about to win several very important infrastructure contracts. The Arabtec situation is not an isolated case with numerous other listed companies witnessing an influx of cash. Penny stocks — including Tabreed, Deyaar and Dubai Investments — have been among the main beneficiaries of the bull-run despite an absence of solid information, and analysts say a lack of transparency in UAE markets has long been a contentious issue for local traders.[555]

For that, the SCA should draft clear rules relating to timely disclosure. It should apply more rigid controls on issuers breaching timely disclosure rules. It should also introduce realistic methods of measuring the time issuers take in meeting the obligations of timely disclosure. The real challenge is in obligating issuers to meet their continuous obligations, especially those of making the timely disclosure of any material non-public information.[556]

Furthermore, the SCA Regulations No. 3 of 2000 [557] obliges all issuers whose securities have been listed in the markets to inform the SCA and each of the markets of 'any significant developments affecting the prices of such securities.' But the problem is that it is not clear whether 'affecting' is likely or definite, which left a grey area without a definite decision from the SCA. Significant matters must affect the prices of securities. Otherwise, there is no obligation on the issuer to disclose the information. Accordingly, it should be amended to be 'any significant developments which are likely to affect the prices of such securities.' [558]

Moreover, a great hindrance to the proper enforcement of the disclosure rules is the weak penalties that are available in the Federal Law No. 4 of 2000 in the case of breach of these rules. Article 43 indicates that any person who contravenes any other provision of this Law and the regulations issued pursuant thereto shall be liable to imprisonment (for a period of not less than three months and not more than three years) and a fine (of not less than one hundred thousand (100,000) Dirhams and not more than one million (1,000,000) Dirhams, or to either of these penalties.[559]

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[554] Msci.com (2013) *MSCI Global Market Accessibility Review*. June 2013. [Online] available from: https://www.msci.com/resources/products/indexes/global_equity_indexes/gimi/stdindex/MSCI_Global_Market_Accessibility_Review_June2013.pdf. [Accessed: 1 June 2014].

[555] Gulfnew.com (2013) *UAE stock market: Working to ensure full disclosure*. 11 March 2013. [Online] available from: http://gulfnews.com/business/markets/uae-stock-market-working-to-ensure-full-disclosure-1.992590. [Accessed: 1 June 2014].

[556] Albelooshi (2008) *'The Regulation of Insider Dealing…,' supra* note 251, at 308-10.

[557] The SCA Regulations as to Disclosure and Transparency, *supra* note 275.

[558] Al Shamisi (2010) *'Investigation into Market Abuse in the UAE…', supra* note 438 at 85.

[559] Articles 41, 42 of the SCA Federal Law of 2000, *supra* note 75.

In contrast, in the UK, the FCA is authorised to levy unlimited fines on wrongdoers, payable to the agency.[560] Therefore, there is no maximum stipulated for fines imposed by the regulator. In addition, the profits that the offender gained or the losses that he avoided and the damages caused by him should be taken into account when deciding the appropriate penalty.[561] The law should authorise the SCA to order the payment of civil penalties as well as disgorgement, as is done in the UK framework.[562]

To be fair though, the UAE government has now changed track on this and has come down hard on perpetrators who commit fraud. However, instances of massive share price appreciation have occasionally happened, primarily as a result of the powerful rumor mill that exists in the UAE's markets and lack of measures to ensure these instances are not repeated. It is possible that the rumor mill in the UAE has the upper hand due to the lack of sophistication of retail investors. Most investors are not especially financially savvy and tend to buy on word of mouth rather than strong fundamentals. It has been intimated that such sharp increased are instigated by majority shareholders interested in share price manipulation.

However, in the UAE, in an effort to boost transparency and investor confidence, the SCA in 2011, signed an agreement with DFM and ADX Markets to start implementing eXtensible Business Reporting Language (XBRL)[563] for listed companies, making the UAE the first MENA country to require XBRL reporting.[564] The promotion of transparency and disclosure is a key requirement for stock exchanges, considering their interest in attracting investors and the absolute need to guarantee said investors with market integrity. Given their role as information gateways, the UAE's exchanges often play a greater role in facilitating company disclosure than promoting other governance issues. Dissemination of information in the UAE equity markets is relatively easy given the small size of the market. Company disclosure of audited financials is currently at 99%,[565] a huge improvement over previous years.

Other significant attempts at improving transparency and disclosure was in May 2013 where certain addition to the existing regulations were introduced in order to regulate the conflict of interest, upgrade investor protection and shareholder liability rules, and review

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[560] Section 91 of the FSMA 2000, *supra* note 163.

[561] See Davies P. (2009) Liability for Misstatements to the Market: Some Reflections. *Journal of Corporate Law Studies.* Volume 9. Issue 2. 295, 304, where Davies encourages the regulator to increase the financial penalties to achieve credible deterrence, wrongdoers must not only realise that they face a real and tangible risk of being held to account, but must also expect a significant penalty. Davies describes the unlimited monetary fine as 'the primary weapon in the hands of the FSA.'

[562] Alhamrani (2011) *'Insider Dealing In the Stock Market…'*, *supra* note 441, at 252-280, 259.

[563] For more information see Xbrl.org (2014) *Financial Statements in XBRL*. [Online] available from: http://www.xbrl.org. [Accessed: 4 April 2014].

[564] Sca.gov.ae (2011) *SCA signs agreement with ADX, DFM to implement XBRL in UAE.* [Online] available from: http://www.sca.gov.ae/English/news/Pages/2011-09-25.aspx. [Accessed: 4 October 2014]; and Sca.gov.ae (2013) SCA showcases its XBRL experience to GCC representatives, calls for setting up XBRL Committee at GCC Level. [Online] available from: http://www.sca.gov.ae/English/news/Pages/02-06-2013.aspx. [Accessed: 4 October 2014].

[565] Sca.gov.ae (2010) *Awraq Maliyah*. Issue No. 4. May 2010. [Online] available from: http://www.sca.ae/arabic /Secured/Publications/OtherReports/AwraqMaliyah_issue4_EN.pdf. [Accessed 23 June 2014].

and overhaul related party transactions and their impact on transparency.[566] Moreover, the SCA has, as of March 2014, made it compulsory for all listed companies to establish a dedicated investor relations department. Furthermore, investors are to be kept abreast of company news as well as kept updated with necessary financial and stock market information.[567]

Notably, providing quality reports creates greater confidence in users to effectively participate in the efficiency of financial markets performance. Emerging markets such as the Arab markets have an exigent need to provide quality reports in order to be able to secure a foothold in the global market and attract more investment. Providing voluntary disclosure is the main key to providing a quality report. Using this method of measuring voluntary disclosure has the benefit of giving more detailed information for each item on the voluntary disclosure index. By giving details of information for each item, the quality of disclosure will be high compared with prior studies conducted on measuring voluntary disclosure.[568]

## 7.2 Suggested Approaches to Systemic Risk Management.

Traditionally, in the UK the FSA has had all-encompassing powers to oversee the conduct of business and prudential regulation, with the BOE having minimal market conduct regulatory authority. Therefore, oversight of systemic risk rests with the FSA. At the time of the crisis, the FSA was the body tasked with policing the financial system, however, it was accused of being far too slow in responding to the Northern Rock affair.[569] In the pre-financial crisis period building up to 2007 & 2008, no one imagined the depth of the looming carnage that was about to take place in the UK's markets. The entire systemic and prudential risk management of the nation were shaken. Theoretically, a single person, a single firm, government, market or policy or event can trigger massive financial instability. In a well-oiled system, all the parts are functioning well. However, the build up to the financial crisis in the UK saw one of those well-oiled parts, namely, Northern Rock Bank, stop functioning. Northern Rock's collapse, exacerbated by the US mortgage crisis,[570] posed massive systemic risk to the UK's financial system because it had contracts, third party agreements and relationships (and obligations) with other parts of the system. A single entity might,

[566] The conflict of interests and the related party transactions and their related provisions were recently introduced in the Ministerial Resolution No. (250) of 2014 Amending Parts of the Ministerial Resolution Provisions No. (518) of 2009 Concerning Corporate Governance Rules and Corporate Discipline Standards. For details of the related amendments, see pages 192-93, *infra*. See also the SCA Resolution of 2009 Concerning Governance Rules, *supra* note 295.
[567] Sca.gov.ae (2014) *SCA board decides to compel listed companies to set up investor relations department*. [Online] available from: http://www.sca.gov.ae/English/news/Pages/09-03-2014.aspx. [Accessed: 29 September 2014].
[568] Al-Janadi, et al. (2012) *'The level of voluntary disclosure practices…', supra* note 340, at 198.
[569] See *supra* notes 178, 324, 325, 332, 369.
[570] Treasury.gov (2012) *Financial Stability Oversight Council 2012 Annual Report*. [Online] available from: http://www.treasury.gov/initiatives/fsoc/Pages/annual-report.aspx. [Accessed: 29 July 2014].

therefore, pose systemic risk because relationships with others can spread and magnify shocks to the financial system as a domino effect.[571]

Thus, the first key legislative act that was to ameliorate both systemic and prudential risk and entirely re-structure the UK financial system was adopted in 2012, namely, the Financial Services Act of 2012.[572] The Bank of England and the Treasury have passed through legislation that moved the regulatory framework towards a Twin Peaks model with prudential regulation of banks separated from oversight of consumer protection and market conduct. The FSA has been gradually phased out to become the FCA as of mid-2013 and the government has set up the Prudential Regulation Authority (PRA) as a subsidiary of the BOE to conduct prudential regulation of financial sector. A new Consumer Protection & Markets Authority (CPMA) will be separate from BOE and will regulate conduct of all financial firms including those prudentially regulated by the PRA.

Notably, that the UK move towards a Twin Peaks regulatory system was a response to the need to address several key systemic issues, and that by introducing the Twin Peaks approach, the UK regulatory bodies would now have more time and personnel to focus on important aspects of systemic risk vis-à-vis the integrated approach (which more often major issues are not allowed to slip through the regulatory cracks). The Twin Peaks Approach to financial supervision is designed to garner all the benefits and efficiencies of the Integrated Approach, while at the same time addressing the conflicts between the objectives of safety and soundness regulation and consumer protection and transparency. It has been referred to as "regulation by objective," whereby one agency's regulatory objective is prudential supervision with the primary goal of safety and soundness and the second agency's goal is to focus primarily on business conduct and consumer protection issues. This permits each authority to clearly focus on its area of expertise. Prudential regulators can employ persons with business and economic expertise while business conduct regulators focus on hiring enforcement oriented staffs. Having the functions in separate entities can minimise conflicts between the two authorities as well as maximise economies of scale and improves accountability.

The Act created a new regulatory framework for the supervision and management of the UK banking and financial services industry. The Act also separated and clarified between two key risks, namely, prudential and systemic. The Act abolished the old FSA and created new bodies each with separate responsibilities for oversight of the market place and financial system. It also gave the Bank of England macro-prudential responsibility for oversight of the financial system and day-to-day prudential supervision of financial firms managing large balance sheet risk (otherwise known as firms that are 'too big to fail'). Three other bodies

[571] The term domino effect best describes the ensuing destruction when one financial institution can no longer honour its obligations to another and so forth on down the line. The failure of one entity can result in the failure of some of its creditors and counterparties. See Kaufman & Scott (2003) *'What Is Systemic Risk…', supra* note 360; Wells, S. (2004) Financial interlinkages in the United Kingdom's interbank market and the risk of contagion. *Bank of England, Quarterly Bulletin*. Volume 44. Issue 3; and Markwat, T., Kole, E. & Dijk, D. (2009) Contagion as a domino effect in global stock markets. *Journal of Banking & Finance*. Volume 33. Issue 11. 1996-2012.

[572] See the Financial Services Act of 2012, *supra* note 170.

were created as well, each with a goal of ensuring that safety and security and integrity of the UK's financial system namely, the Financial Policy Committee (FCP), the Prudential Regulatory Authority (PRA) and the Financial Conduct Authority (FCA).

The new Act also made extensive changes to the FSMA 2000 as well as the Bank of England Act 1998 and the Banking Act of 2009. In fact, the new Act (Section 7) further empowered the new FCA to impose stiffer fines and penalties on violators in the market place.[573] The FCA has three objectives to achieve, namely:

- To secure an appropriate degree of protection for consumers (the consumer protection objective) (new Section 1C, FSMA).[574]
- To protect and enhance the integrity of the UK financial system (the integrity objective)[575] (new Section 1D, FSMA).
- To promote effective competition in the interests of consumers in the markets for regulated financial services and services provided by recognised investment exchanges in carrying on certain regulated activities (the competition objective) (new Section 1E, FSMA).[576]

Legislation is a key tool for making changes to any system. Amelioration of systemic risk by the Authorities also included empowering the FCA to take strong legal action against any offender in the financial market thus sending a strong message to market participants that there will be zero tolerance towards fraud, market abuse, insider dealing and stock manipulation.

As a result of new legislation the FCA's scope of activities now include conduct of business (COB) regulation for all firms in both retail and wholesale markets. The FCA is responsible for the conduct of business regulation of all regulated firms, including PRA-authorised firms and firms "passporting" their way into the UK. The FCA also inherited the former FSA's existing roles relating to markets regulation under Part XVIII of FSMA.[577] Institutions that provide both exchange services and central counterparty clearing services will be regulated by the Bank of England with respect to their activities as Recognised Clearing Houses (RCHs) and by the FCA as Recognised Investment Exchange (RIEs).

Finally, the FCA has inherited the former FSA's responsibilities for the regulatory oversight of client assets and countering financial crime. The 2012 Act also made some key changes to the power vested in the FCA and its ability to prosecute. This added empowerment was another tool given by the Government to the FCA to make it more

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[573] See Gibson & Crutcher (2012) *'Memorandum Financial Services Act 2012…'*, *supra* note 183.

[574] HM Treasury (2012) *A new approach to financial regulation: draft secondary legislation*. October 2012. [Online] available from: https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/191571/condoc_fin_regulation_draft_secondary_leg.pdf. [Accessed: 12 August 2014].

[575] Gibson & Crutcher (2012) *'Memorandum Financial Services Act 2012…'*, *supra* note 183.

[576] Financial Services and Markets Act 2000, *supra* note 163.

[577] Legislation.gov.uk (2000) *Financial Services and Markets Act 2000, Part XVIII Recognised Investment Exchanges and Clearing Houses*. [Online] available from: http://www.legislation.gov.uk/ukpga/2000/8/part/XVIII. [Accessed: 13 August 2014].

effective and some would say, more independent from the old FSA. In fact, the new Financial Services Act made quite a few amendments to the powers and responsibilities of the FCA as reflected in the old version of the Financial Services & Markets Act 2000. They include integrating the UKLA into the new FCA and applying the general FCA objectives to the listing regime; extending the powers of the FCA to impose sanctions on sponsors for breaches of UKLA rules and requirements imposed on sponsors (Section 18 of the Act). This will include the ability to impose financial penalties and to suspend a person's approval as a sponsor or restrict their activities.

The FCA has the power to regulate primary information providers ("PIPs") (organisations which channel information from issuers to the UKLA and announce information to the market) (Section 19 of the Act). Furthermore, the FCA is empowered to direct a firm to withdraw a financial promotion that the FCA considers is likely to breach its rules concerning financial promotion, subject to certain safeguards. The UK Government believes that credible and effective enforcement action should remain a key focus for the FCA. The FCA will continue the FSA's policy of credible deterrence by focusing increasingly on those in senior management that fail to recognise and manage their firms' risks, that fail to control the way that products are sold, and that fail to ensure that consumers' interests are prioritised when designing financial products as well as having a low tolerance for repeat offenders.

The UK's shift, from an integrated approach of financial regulation to that of a 'Twin Peaks' regulatory system is, in effect, a deep reflection of the changes required by the Authorities and Parliament to avoid the threat of systemic risk. The UK's integrated "tripartite" regulatory approach, namely; the BOE, FSA and the Treasury were collectively responsible for the financial stability of the UK capital markets and this system apparently failed to effectively identify the issues that were building in the financial system as well as to take steps to mitigate these issues.

Unlike the UK, the financial crisis did not cause as much financial loss in KSA.[578] Certainly, Tadawul slowed down and retail investors lost a lot of money but the overall market is generally well insulated from the knock-on domino effect of Western markets. KSA investors had, by the very fact of their isolation, limited exposure to US and UK collaterised debt obligations and had minimal direct leverage from large the US and the UK financial institutions. Cash reserves remained level and were sufficient to meet the needs of the nation. At no time did SAMA consider or require the need to shut down financial institutions in order to avoid counterparty risk default. There was no threat to systemic risk and was not required at any stage to pass any key legislation to ameliorate any systemic risk.[579] Banks were well capitalised and local bank lending was stable.[580]

[578] Worldfinance.com (2013) *Saudi banking sector rock solid despite global economic crisis*. 13 September 2013. [Online] available from: http://www.worldfinance.com/banking/investment/saudi-arabia-weathers-the-storm. [Accessed: 18 August 2014].
[579] Sama.gov.sa (2014) *Latest News*. [Online] available from: http://www.sama.gov.sa/sites/samaen/Pages/Home.aspx. [Accessed: 20 August 2014].

The International Monetary Fund report on KSA,[581] estimated the total amount of KSA banks' exposure to CDO in the US amounted to 3% of banks total assets. However, KSA authorities need to prepare for the eventual day when the market will be opened up to foreigner and direct foreign investment. At the moment, it is totally unprepared to keep and attract first class international investors. Mitigation of future systemic risks would best be served by ensuring corporate disclosure is up to global standards. Furthermore, SAMA, from a prudential risk perspective has made substantial efforts to introduce Basel II and III requirements especially for large exposures and connected parties. It is the recommendation of the IMF that SAMA address fundamental risk issues by bringing all aspects of risk management into one singular document so as to reflect required changes in market risk and internal controls.[582]

SAMA has never had to face a meltdown in systemic risk that the rest of the world experienced and in some cases is still experiencing. However, the closest that any major KSA entities experienced any form of collapse which may have had a strong impact on KSA financial systems was the widespread bank losses caused by the 2009 failure of Al-Gosaibi& Bros Co. and the Saad Group, two very large and well known KSA conglomerates.[583] It would appear that SAMA needs to strengthen credit risk management techniques used by organisations in KSA. Nevertheless, SAMA responded to this default by ensuring that all losses were provisioned for.

SAMA also initiated interbank discussions and dialogue to help identify the reason behind such a massive default. Clearly, the matter relates to fraud and financial mismanagement but SAMA did well to highlight the fact that name lending (where banks lend vast sums of money to an organisation based upon the name and reputation of the firm only and not on its actual financial ability to service its debt) must be accompanied by close scrutiny. Individual large exposure must be scrutinised to ensure they are not a threat to the KSA financial system. It is noted that SAMA, over the years has consistently encouraged KSA banks to build prudent capital and provisioning buffers which, no doubt, has proved invaluable throughout the crisis and throughout the collapse of Al Gosaibi. SAMA has also introduced international accounting and auditing standards (IFRS & ISA).[584]

In conclusion, KSA financial authorities have, to date, appeared to be pro-active in light of the current global conditions. The Capital Market Authority (CMA) and SAMA have attempted to regularly address key issues faced by market participants that are unique to them and are not necessarily reflective of events occurring globally. KSA equity capital markets are somewhat more immune to the vagaries and shifts in global currents simply because the market is still so isolated.

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[580] Al-Hamidy, A. (2010) The global financial crisis: impact on Saudi Arabia. *BIS Papers*. No 54. 347-357. [Online] available from: http://www.bis.org/publ/bppdf/bispap54u.pdf. [Accessed: 20 August 2014].

[581] The IMF (2012) *'Saudi Arabia: Reports on the observance of standards and codes*,' *supra* note 342.

[582] *Ibid.*

[583] For more information on Algosaibi and Sa'ad Al Sanea cases, see *supra* notes 376 & 377.

[584] The IMF (2012) *'Saudi Arabia: Reports on the observance of standards and codes*,' *supra* note 342.

The approaches used by UAE financial Authorities including the CBUAE and the SCA to ameliorate systemic risk management issues are more varied than those of KSA. The financial crisis had a clearly negative impact on the UAE. Unlike KSA, whose market is closed to the outside world, the UAE's equity capital markets as well as banking system is relatively open to the influences of the external world. Decisive action by the CBUAE, the Ministry of Finance, the SCA and other responsible bodies helped to moderate the crisis. Infusion of liquidity into the markets by the deposit of long term government funds at banks, re-capitalisation of UAE banks and the tightening of lending rules to the real estate and construction sectors occurred almost overnight.

The financial crisis led to the SCA reviewing its licensing rules for brokerage houses with the subsequent shutting down of over 50 brokerage houses over a 2 year period after the onslaught of the financial crisis. It also led to giving more attention to risk management of its licensed institutions especially in the aftermath of the delisting of the two of the UAEs' largest mortgage lenders that were listed on DFM Amlak and Tamweel on 2008. Many measures from the federal government were taken in response to the two companies and the troubled property sector.[585]

Similar to the UK, the significance of the danger to the UAE's systemic risk driven the UAE Authorities to consider a Twin Peaks approach to financial regulation, like the approach adopted by the Netherlands and Australia.[586] The advantages of the Twin Peaks approach are well documented and will basically permit the regulation of the UAE's capital market sector by means of a bi-pronged methodology whereby conduct of business regulations including that of banks and insurance companies, will essentially be the domain of the SCA and prudential regulations and systemic risk the remit of the CBUAE. Notably,

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585 For more information on the government measures in relation to the two companies, see Gulfnews.com (2014) *New judicial panel to be set up for Amlak, Tamweel disputes*. [Online] available from: http://gulfnews.com/news/gulf/uae/government/new-judicial-panel-to-be-set-up-for-amlak-tamweel-disputes-1.559819; Fitch, A. (2014) DIB to take reins at Tamweel. *The National*. 27 September 2010. [Online] available from: http://www.thenational.ae/featured-content/work-in-progress/dib-to-take-reins-at-tamweel.; Kane, F. (2014) Amlak reaches deal in $2.7bn debt and hopes to resume share trading, 7 August 2014. *The National*. [Online] available from: http://www.thenational.ae/business/banking/amlak-reaches-deal-in-27bn-debt-and-hopes-to-resume-share-trading.; and Al Aidarous, A. (2010) Promulgation of By-Laws for Interim Real Estate Registration Law. *Legal Pinch Quarterly Newsletter*. [Online] available from: http://www.aidarous.com/publications/LP-4-2012.pdf. [Accessed: 21 August 2014].

586 In the Netherlands, the Dutch have also adopted the Twin Peaks system and have similarly been very successful in avoiding some of the pitfalls that the US and UK markets had to go through as a result of the crisis. The Central Bank of the Netherlands (DNB) is the nation's prudential supervisor of all banking and financial institutions and the Netherlands Authority for Financial Markets (AFM) supervises conduct of business. The Twin Peaks approach was adopted in 2002 as a result of several large financial institutions merging (and the resulting prevalence of very complex and complicated financial instruments). The Government at the time thought it prudent to switch to a Twin Peaks from a standard institutional approach where regulation was divided along the traditional lines of banking, insurance and securities.The Dutch and Australian financial regimes may have proven to be the optimal means of ensuring that issues of transparency, market integrity, and consumer protection receive sufficient priority. See Hill, J. G. (2012) Why did Australia fare so well in the global financial crisis?. In: Ferran, E. et al. (eds.). *The Regulatory Aftermath of the Global Financial Crisis*. United Kingdom: Cambridge University Press. 203-300; Bowen, C. (2010) Responding to the financial crisis – Financial Reform Impacts and Regulatory Regime Changes. *In Asian Financial Forum*. Hong Kong. Wednesday, 20 January 2010; and Michael, B. (2014). The "Twin Peaks" Regulatory Model: The future of financial regulations. *Banking Today*. Mar-Apr 2014. [Online] available from: http://www.law.hku.hk/aiifl/wp-content/uploads/2014/09/Twin-Peaks.pdf. [Accessed: 10 July 2014].

the UAE has not, as of yet, adopted this approach to financial regulation even though discussions and research on the topic have been extensive. It is expected that the UAE will adopt the Twin Peaks regulatory system within the next two years. [587]

Decisive policy actions by the authorities have helped moderate the effect of the crisis. These actions included the infusion of liquidity into the financial system through repos by central banks, and direct liquidity injections via the placement of long-term deposits by the government, provision of deposit guarantees and capital injections to banks, and, as preemptive measures, tightening of prudential norms for general lending and in particular for lending to real estate and for investment in equity.

In conclusion then, amelioration of systemic risk management issues can best be achieved by what the FCA refers to as "Regulation by Objective." Each regulatory body is tasked with focusing on one key area of the financial system. In this case, matters related to prudential regulation and the safety and soundness of the financial system fall within the responsibility of the Central Bank. In the UK, this falls under the PRA; in KSA it is SAMA and finally in the UAE it is envisaged to be the CBUAE. Conduct of business affairs as well as consumer protection fall under the FCA, the CMA in KSA and the SCA in the UAE. This separation allows each body to focus entirely on the job at hand. The benefits to this approach includes rapid policy response in times of crisis as well as (it is hoped) effective coordination between both regulatory agencies.

Another point of interest that needs highlighting is closely related to disclosure as well as management of systemic risk. The increasing complexity of transactions and financial instrument makes it very hard for investors and even those who operate within financial institutions to actually understand the complex nature of these instruments. A lot of information is disclosed in today's prospectuses or information memorandums but not everyone appears to understand the implication of purchasing such complex investments, especially the rating agencies. Furthermore, separating the PRA & the FCA allows for rapid policy response and could ensure that regulatory frameworks keep pace with dramatic changes and innovations in financial markets. It also facilitates effective coordination among the regulatory agencies, the BOE and the Treasury thus allowing for better monitoring of the financial system.

From a securities markets perspective, key risk management issues such as the settlement of securities has been addressed by SAMA and the CMA to ensure that systems work safely and efficiently. In July 2013, the IMF published the completed full assessment of the Saudi Securities Settlement Systems (SSSS).[588] The IMF also assessed the CMA's

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[587] Arnold, T. (2012) New financial services watchdog for UAE. *The National*. 20 May 2012. [Online] available from: http://www.thenational.ae/business/industry-insights/economics/new-financial-services-watchdog-for-uae [Accessed: 26 December 2014].

[588] See Imf.org (2013) *Saudi Arabia: Financial Sector Assessment Program Update—Detailed Assessment of Observance of the CPSS Core Principles for Systemically Important Payment System.* IMF Country Report No. 13/214. July 2013. [Online] available from: http://www.imf.org/external/pubs/ft/scr/2013/cr13214.pdf. [25 October 2014].

Securities Depositary Center (SDC) using the CPSS-IOSCO Recommendations for Securities Settlement Systems (RSSS).[589]

In the assessment of the CMA, the SDC is in full compliance with fourteen of the CPSS-IOSCO recommendations. The self-assessment outlines that the legal framework governing the SDC is well-founded, clear and transparent. The laws, regulations and procedures governing the system are public and readily accessible to participants. Settlement risk is minimised by several aspects of the legal and technical framework. Furthermore, other key risks that may be prevalent in some more advanced market simply do not exist on Tadawul due to the existence of caps and controls such as the complete ban on short selling and zero derivative trading.[590]

Furthermore, Tadawul operates the (SDC), which, as per the KSA's CML, is tasked with the provision and execution of all equities transactions including settlement, deposit, clearing as well as registration of ownership of securities traded on Tadawul. Tadawul is aware of other key risks that it's equity market may face in the future and is currently in discussions (in conjunction with SAMA and the CMA) to implement a (DVP) system.

As previously indicated, the impact of the financial crisis on the UAE exchanges and the economy were huge. Losses on the DFM and ADX were in billions and share prices on the DFM suffered their biggest fall amid fears that a debt crisis is looming as Dubai World, giant conglomerate owned by Dubai government, asked its creditors for a six month debt payment delay. Dubai World debt was to become the Achilles heel of Dubai's recovery. From the onslaught of the crisis in mid-2008 till March 2014, the SCA has issued several very important regulations aimed at improving the safety and security of the capital markets as well as at improving investor confidence. Margin trading regulations were effectively established in 2008 as were regulations relating to safe custody; capital adequacy requirements for brokerage houses were released in 2010. Several other new rules have been passed as well that promote the use of new types of financial instruments such as covered warrants, securities borrowing and lending and investment management in order to boost and improve overall trading volumes and market depth.

While the CBUAE has established a Banking Stability Committee, currently it has no authority to include financial institutions outside the banking system in its macro prudential surveillance. Responsibility for systemic risk mitigation is divided between the Banking Stability Committee which is ultimately responsible for any action taken, and the Financial Stability Unit which provides the analysis, and proposes regulatory reforms to address identified risks. However as previously stated, the authorities are considering legislation governing the supervision of the financial sector to meet the demands of the UAE's new financial markets and modernise the regulatory framework. The draft law on the Regulation

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[589] See Imf.org (2013) *Saudi Arabia: Financial Sector Assessment Program Update—Detailed Assessment of Observance of the IOSCO Objectives and Principles of Securities Regulation*. IMF Country Report No. 13/212. July 2013. [Online] available from: http://www.imf.org/external/pubs/ft/scr/2013/cr13212.pdf. [Accessed: 25 October 2014]. See also Iosco.org (2001) *Recommendations for securities settlement systems.* [Online] available from: http://www.iosco.org/flibrary/pubdocs/pdf/IOSCOPD123.pdf. [Accessed: 25 October 2014].
[590] *Ibid*.

of the Financial Services Sector in the UAE and associated amendments to a number of federal laws could signal a move towards a twin peaks model of financial supervision.[591] Therefore, while there are no clear formal arrangements of sharing information among regulators exist as it is done on a voluntary basis, it is expected that more established mechanisms among regulators will be created once the Twin Peaks regulatory model kicks off.

## 7.3 Suggested Approaches to the Shortage of Institutional Investors within the Markets and the Investor Confidence

It is indeed interesting to note the significant difference in action between global regulators during the financial crisis. In the UK, short selling, CDO's, swaps and derivatives are generally seen as the instruments that caused most volatility with subsequent bans by the FSA on short selling and a total revamping of OTC derivative regulation including Parliaments passing of the 2012 Financial Act and the introduction of a 'Twin Peaks' system. The UK authorities certainly have been busy in their attempts to reduce systemic risk, market volatility and increase investor confidence.

In KSA, the herd instinct, isolationism, poor investor education as well as dismal KSA company performance caused massive fluctuations which led the CMA to ban evening trading, shut down online Internet trading sites, increase investor education as well as conduct road shows to attract large institutional investors vi-a-vis the mass of unsophisticated retail investors awash in the market.Tadawul was (and in some ways continues to be) volatile for many reasons (which once again gives credence to its 'standalone' classification by MSCI). Individuals still account for the majority of transactions and consequently, sections of the market are highly speculative, with market moving rumours, panic selling, insider dealing, front running and manipulation commoner than in more developed markets. Since the investment culture is still considered immature and emotionally driven, the CMA expends great energy in educating the public directly or through its brokers in order to correct this uninformed market etiquette manifested by local investors.[592]

In a similar vein to KSA, investors in the UAE are mostly retail and are similarly to some extent unsophisticated. Dispersal of market information is by way of mouth and the rumour mill. As a result of this, the UAE stocks have also been prone to a degree of volatility. Disinformation and lack of transparency, like KSA, have also caused increased fluctuation. A closer look to the UAE markets indicates that they are dominated by individual investors. There are four sectors to hold shares in the UAE companies. These are: individuals, companies, governmental institutions and other sectors (usually charities in the

[591] Imf.org (2013) '*United Arab Emirates: Selected issues,' supra* note 303.

[592] Althanyan, F. (2011) *Demands for the Enhancement of Investor Confidence, the Restructuring and the Creation of Incentive Policies in the Stock Market*. 4 September 2010. [Online] available from: http://www.alriyadh.com/557052. [Arabic]. [Accessed: 29 August 2014].

case of the UAE).[593] Therefore, a large percentage of the investors in the UAE markets are thought to be individual short-term speculators. Individual investors' dependence on sentiment and herding to make their investment decisions resulted in a volatile market. The current situation of individual investor domination is detrimental to the market in terms of volatility and risk and the authorities in the UAE should work to attract institutional investment into the markets.[594]

Hence, one of the key similarities between KSA and UAE equity markets is that they both suffer from an overabundance of retail investors. Opportunistic buyers, who are, more often than not, unsophisticated investors, flood the DFM & ADX exchanges in the UAE as well as Tadawul in KSA to such an extent that it is considered the norm rather than the exception. The speculative cash floods in and, just as quickly, pours out when news is bad and markets drop. Two key solutions to this adopted by KSA and the UAE is to attract more long term institutional investors. How was this achieved?

In general, one of the most desirable features that international and institutional investors would like to see in a market is that no distinction is made between local and international investors. The international standard for developed markets is the absence of any investor qualification requirement. In the UAE, the 2014 MSCI upgrade of the equity markets from "frontier" to "emerging" is the fruition of years of hard work by the SCA and other financial authorities to improve the rules and regulations particularly with regard to the introduction of foreigner investors directly into the market. Foreign institutional buyers may instruct their brokers to directly purchase equities in the markets in the UAE today up to limit as listed companies in the UAE are subject to foreign ownership limits. The UAE Commercial Companies Law states that foreigners may own up to 49% with the rest owned by locals.[595] This would appear to be one of the key remaining points of contention amongst institutional foreign investors as well as foreign room level.[596] In the UAE, listed companies may choose to limit the amount of trading that is permitted in their shares for foreigners. Some choose 20%, other less and some more. This means that if a foreign investor wishes to purchase X stock, he may be unable to do so since at the time of purchase foreigners already own the maximum permissible percentage of stock that is allowed.

This also means that the foreign investors have to either cancel their orders or wait for it to be fulfilled at another price. Clearly, this is not in line with large foreign institutional investor strategy since they would expect to carefully buy up positions at certain specified prices until the time comes to sell them. Foreign ownership limits are unattractive for

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[593] In DFM, individuals bought an average of 74.8% of the total stock bought during the period from 2010 till 2014, and sold an average of 75.8% for the same period. These figures illustrate the percentage of retail investors in the local stock markets. It is clear that institutional investors average trading (buy and sell) had not exceeded 25% on average for the comparable period.On the other side, ADX's trading figures shows higher percentage of institutional trading. The asthmatic mean of average securities bought by individuals for the period from 2010 to 2014 was 67.6% comparing to 32.4% for the institutions. These percentage increases for the average sell to reach 68.2% and decrease to 31.8% for the individuals and institutional investors respectively. See Esm.sca.ae (2014) *Trade History Reports*, *supra* note 78.

[594] Albelooshi (2008) *'The Regulation of Insider Dealing…,' supra* note 251, at 73.

[595] See the UAE Federal Law No. 8 of 1984 Concerning Commercial Companies, *supra* note 65.

[596] See the MSCI Global Market Accessibility Review, *supra* note 554.

foreigners but does have the added benefit of protecting the local investor community. It does, it would appear, have its merits. To date, the Authorities have managed to walk a thin line between balancing the needs of the local investor community and assuaging the investment appetite of the large international players.It is hoped that the introduction of these rules will encourage long term investors (who are more often foreign institutional investors) to maintain long positions and thus counteract speculation. This will subsequently reduce market volatility when speculative capital flows outwards.

In KSA, CMA has recently announced that foreign investors will be permitted to directly enter the markets as opposed to dealing via KSA brokers using swap agreements.[597] However, regulation to address this issue has still not been 'officially' passed but international investor appetite is buoyant and the expectation is that the CMA will authorise this within the foreseeable future. Unless stable and long term equity investors are allowed to directly participate in Tadawul, KSA will contain to be plagued by speculative capital flows within its markets.

Additionally, a key regulation amended by the UAE financial Authority, the SCA, was the recent change to margin lending. Margin lending-borrowing with cash or share holdings as security, has been in high demand as investors sought to maximise gains from a UAE market surge, with Dubai and Abu Dhabi's exchanges jumping 108 percent and 63.1 percent respectively in 2013.[598] Limits on such lending were introduced in 2008, but many brokers ignored these and faced few repercussions. The SCA has now made changes to what firms can lend customers and has become stricter in fining brokers who breach regulations. Unable to meet margin calls, many investors are wiped out and brokers are forced to dump stock to recover losses. This practice has added to market volatility in the UAE and has now been addressed by the regulator. Fines for breach of this regulation can reach 100,000 Dirhams as the SCA is determined to stamp out illicit margin lending.[599]

Perhaps more telling is the SCA's efforts to reduce market volatility during the IPO boom period in the UAE of 2007. At the time, local UAE banks fueled the boom by financing investors with huge sums of money. Investors become over leveraged as a result and banks expected to realise quick profits (at the time, the UAE and in general GCC equity markets were considered a sure thing for investors).This reckless lending by banks to investors was curbed by the Authorities. The SCA introduced regulations that prevented start-up companies from immediately seeking a share listing (they needs to have a three year track record) and the CBUAE passed a law requiring commercial banks not to provide loans

[597] See Draft Rules for Qualifies Foreign Financial Institutions Investment in Listed Shares, *supra* note 213; and SaudiGazette.com (2014) *Opening Tadawul to foreign investors a step in the right direction: Alkhabeer*. 2 November 2014. [Online] available from http://www.saudigazette.com.sa/index.cfm?method=home.regcon&contentid=2014102223084.[Accessed: 2 November 2014].

[598] M.arabianbusiness.com (2014) *UAE market regulator issues new rules, penalties*. 5 January 2014. [Online] available from: http://m.arabianbusiness.com/uae-market-regulator-issues-new-rules-penalties-533601.html. [Accessed: 29 August 2014].

[599] See the SCA Decision No. (25/R) of 2008 Concerning Margin Trading, *supra* note 3.

to investors more than a certain amount in an attempt to limit and reduce commercial and personal leverage.[600]

The carnage in the UAE equity markets is well documented. Thousands of investors lost their money overnight, banks stopped lending money to anyone, liquidity dried up, cars and homes were repossessed, foreigners and expats with outstanding dues ran away to avoid imprisonment and the entire construction and real estate sectors came to a grinding halt. Unlike KSA, the UAE markets are accessible to investors and are therefore susceptible to global changes. This susceptibility to global currents and openness to foreign investment is a double edged sword. Unlike KSA, foreign investors actively invest in the UAE stock markets and as of December 2013 had invested well over US$ 700 billion into the DFM & ADX.[601]

However, ensuring stability as well as lowering volatility is vital for the UAE since the outflow of foreign investors could have the same crippling consequences it did in 2008 when the global financial crisis caused a sudden out surge in investment leaving a crippling liquidity gap in its wake. Since 2008, the authorities in the UAE have taken measures to strengthen some of the weak links in the system. Banks have been recapitalised and the capital adequacy ratio of the banking system has strengthened to 21 percent.[602] Weaker financial institutions, including banks, have been merged with stronger institutions.

Although short selling is common in developed markets, its use on the UAE's local markets was unregulated and that is what made it especially risky. While many stock brokers and financial institutions say they engage in short selling, the SCA does not recognise the practice, so investors are unable to sue and seek damages if short-selling contracts are broken and because of a lack of regulation, data about the number of investors selling short also goes undisclosed, putting other traders at a disadvantage. In part for these reasons, the SCA spoke out against short selling and administrative sanctions had been taken by the SCA against 45 brokerage companies for different breaches and short selling was one of them.[603] Regardless that the SCA passed covered short selling regulation in 2012 but to date short sellers do not operate on either the DFM or ADX yet.[604]

As retail investors continue to dominate the bulk of trading activity the Authorities believe that more investment is required from overseas to ensure healthy returns and long-

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[600] Spindle, B. (2008) UAE guarantees banks and deposits. *The National.*12 October 2008. [Online] available from: http://www.thenational.ae/business/banking/uae-guarantees-banks-and-deposits. [Accessed: 29 August 2014].

[601] Al Sayegh, H. (2013) Foreign investors pile into the UAE as Dubai's Expo 2020 bid buoys interest. *The National.* 23 November 2013. [Online] available from: http://www.thenational.ae/business/industry-insights/markets/foreign-investors-pile-into-the-uae-as-dubais-expo-2020-bid-buoys-interest. [Accessed: 25 August 2014].

[602] See Imf.org (2013) *'United Arab Emirates: Selected issues'*, *supra* note 303.

[603] See Sca.gov.ae (2006) *Administrative sanctions taken by the Securities and Commodities Authority against 74 violations*. [Online] available from: http://www.sca.gov.ae/Arabic/news/Pages/2006-06-17-36.aspx. [Arabic]. [Accessed 25 August 2014]; and Al Sayegh, H. (2009) Short selling, the secret everyone knows about. *The National.* 30 December 2009. [Online] available from: http://www.thenational.ae/business/short-selling-the-secret-everyone-knows-about#page1. [Accessed: 25 August 2014].

[604] Decision No. (48) of 2012 Concerning the Regulations as to Short Selling of Securities. See the SCA Rules and Regulations, *supra* note 3.

term prosperity. To ensure this happens, Authorities consider the fact that investor education is vital towards increasing investors. Investor roadshows as well as educational programs conducted by both DFM and ADX help towards narrowing the gap. Furthermore, running parallel to the UAE's efforts in attracting institutional investors, ADX strategy changed in 2009 towards offering a more sophisticated array of investment opportunities in the hope of attracting well-heeled international investors. As a result of this, the UAE's first exchange traded fund was listed and offered to investors. The primary advantage of an ETF is that investors can achieve a diversified portfolio by buying into one while avoiding the costs of purchasing a similar range of individual shares.[605]

Recently, the SCA's efforts of developing a set of regulations aimed at introducing market makers as well as securities borrowing and selling regulations and short selling is an attempt to provide international investors with greater flexibility as well as a familiarity with financial instruments which they are more used to utilising. The benefits of these regulations have yet to be felt by the UAE but it is expected that having market makers in the UAE markets will help in supporting UAE financial markets by maintaining the balance in the market; adjusting the pace therein and striving to attract more foreign investments. The success of the market maker to perform its role in UAE markets would be based on the accurate application of the instructions and controls governing trading on the market as stipulated by the regulations and legislations concerning the functions of the market.

These regulations and legislations stress the need for disclosure and transparency in transactions; prices to be determined based on normal interactions and successful promotional efforts to attract savings and direct them to lucrative investment channels to ensure optimal allocation for individuals and the society. However, the most important function of these markets would be realised, namely the ability to liquidate stocks quickly and easily, and to maintain a continuous balance between supply and demand, thus limiting price fluctuations, to have a fair price and to ensure continuity of the market's ability to carry out its duties and achieve its goals.[606] Similarly, regulation for covered warrants has already been passed by the SCA as well as investment funds, which, it is hoped, will attract more institutional investors to the country.

There is no doubt that the prime objective of the securities market regulators must be the protection of investors. Investor confidence can only be achieved through a consistent and systematic application of rules that apply to all market participants. In the researcher's opinion, only equitable treatment of any and all market participant in the financial markets will result in sustained investor confidence. Equitable treatment of market participants means that the rules apply to everyone without exception. Additionally, consistent and regular dissemination of information is integral to a well-functioning market. Disclosure of information means that market participants must divulge required financial information that

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[605] Professionaladviser.com (2010) *Abu Dhabi lists first ETF*. [Online] available from: http://www.professional adviser.com/etfm/news/1598466/abu-dhabi-lists-etf. [Accessed: 25 August 2014].

[606] Sca.gov.ae (2012) *SCA Board Approves Market-Maker Regulation*. [Online] available from: http://www.sca.gov.ae/English/news/Pages/2012-10-04.aspx. [Accessed: 25 May 2014].

avoids, in all circumstance, informational disadvantages that permit some participants an advantage over others. In essence then, investor confidence can only be achieved through:

- Full disclosure and transparency.
- Equitable treatment of all stakeholders.

A lack of investor confidence means a lack of trust in the fundamental mechanics underlying the system. It is for this reason that the MSCI Index still classifies KSA as a 'stand-alone' market. Negative feedback from large institutional investors provides MSCI with the necessary data to make an assessment and it is this feedback that is vital for the international financial community to make an assessment as to whether to invest in a country or not. Authorities in KSA are aware that they need to address and improve investor confidence. They have approached this by attempting to follow through on two key objectives, namely; ensuring that market participants that violate regulations are punished and named – thus bringing equitable treatment to the market and secondly, attempting to pass regulations that will allow foreign investors access to Tadawul without having to enter into swap agreements with KSA broker/dealers. Investors need to see that that policies and rules are enforceable thus bringing disclosure and transparency to the market.

For example, both the financial regulators the CMA and the SCA, have adopted rules to ensure that disclosure of information is adhered to by listed entities. The CMA has made tremendous efforts towards not only to attempt to inform the general public about annual and quarterly results and to provide information on their board of directors and corporate governance issues. Moreover, the CMA also started in 2013 disclosing its own financial statements and performance.[607]

Similarly, in the UAE, the SCA has ensured that listed company financial disclosure is released in a timely and consistent fashion and that this information is available to investors on the SCA website, and for that the SCA has achieved high rates of disclosure over the years.[608] Such disclosure of information ensures that there are no informational disadvantages in the market that would allow an investor a degree of leverage over another. It may, therefore, be said to be an equitable distribution of information. Maximising investor confidence is a function of fair dissemination of information as well as equitable treatment of all investors in the market. These are not mutually exclusive matter and must be both present and functioning in an equity market for investors to have trust in the mechanics of the market.

[607] The CMA 2013 annual report. See Cma.org.sa (2013) *Capital Market Authority Annual Report 2013*. [Online] available from: http://www.cma.org.sa/En/Publicationsreports/Reports/CMA%20En-Annual%20 Report% 202013.pdf. [Accessed: 4 October 2014].

[608] For more details on the disclosure percentages, see Sca.gov.ae (2014) *Disclosure Percentage of the Public Joint-Stock Companies*. [Online] available from: http://www.sca.gov.ae/English/miscellaneous/Pages/search page.aspx?k=disclosure%20percentage&s=. [Accessed: 2 October 2014].

### 7.4 Suggested Approaches to Insider Dealing.

Closely linked to corporate governance issues is the topic of market abuse. Most of the financial markets suffered, in some form or other, malpractices within the securities markets.[609] The formal passing of federal laws aimed at protecting investors and market participants have been passed with an eye to curtailing negligent and fraudulent behavior. However, the crime of insider dealing is one of the most difficult illegal practices to be detected.[610] In today's hyper-connected traded markets as a result of the globalisation of these markets and the rapid development of the e-commerce and e-trading makes it a lot more difficult to detect and subsequently prosecute insider dealing.[611] The investigations are often more onerous and huge resources are expended by regulators to ensure that member firms and licensed individuals maintain high ethical standards.[612]

Insider dealing is considered to be a type of securities fraud and it is a serious crime.[613] Such fraud leads to breaching a fiduciary and trust duties between the bargaining parties and the insiders or outsiders, who deal with undisclosed information. Insider dealing gives insiders advantages derived from their unjust acts when they get and use information without cost.[614] Effective regulation of insider dealing has an important role to play in ensuring confidence in the markets.[615]

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[609] Dewar, S. (2007) Market Abuse Policy & Enforcement in the UK. In *Market Abuse Seminar*. 22 May 2007. [Online] available from: http://www.fsa.gov.uk/pages/Library/Communication/Speeches/2007/0522_sd.shtml. [Accessed: 3 October 2014]; and Newkirk, T. C. & Robertson, M. A. (1998) Insider Trading - A US Perspective. The 16th International Symposium on Economic Crime. *The SEC Speeches Index*. Jesus College. Cambridge, England. 19 September 1998. [Online] available from: http://www.sec.gov/news/speech/speech archive/1998/spch221.htm. [Accessed: 4 December 2014].

[610] Ferguson, C. (1986) Analysis: Why Insider Dealing is so Difficult to Detect. *The Times*. London.

[611] Examples of electronic means to carry out securities transactions that take place around the world include the Internet, telephones, coded text messages, instant messaging, and chat rooms. See, e.g., Prentice, R. A. (1999) The Internet and Its Challenges for the Future of Insider Trading Regulation. *Harvard Journal of Law & Technology*. Volume 12. No. (2). 263-364.; and Fletcher, N. (2007) Challenges For Regulating Financial Fraud in Cyberspace. *Journal of Financial Crime*. Volume 14. Issue 2. 190- 207. An example in the UK for insider dealing via mails and text messages is the case of Mr. Hutchings and Mr. Smith where they were fined £18,000 and £15,000 respectively by the FSA for insider dealing, they interacted with each other by and exchanged inside non-public information via emails and text messages regarding the progress of the takeover talks. See Fsa.org.uk (2004) *FSA Fines former analyst and former director for market abuse*. Press Release. FSA/PN/107/2004. 16 December 2004. [Online] available from: http://www.fsa.gov.uk/Pages/Library/ Communication/PR/2004/107.shtml. [Accessed: 4 December 2014].

[612] Dooley, M., P., (1980) Enforcement of Insider Trading Restrictions. *Virginia Law Review*. Volume 66. No. 1. 1-83; Zekos, G. I. (2005) Is the law effective in protecting markets from insider trading?. *Hertfordshire Law Journal*. Volume 3(2). 2-17; Dewar (2007) *'Market Abuse Policy &Enforcement in the UK…'*, *supra* note 609; and Newkirk & Robertson (1998) *'Insider Trading - A US…'*, *supra* note 609.

[613] McGee, R. W. & Walter, E. B. (1989) Information, Privilege, Opportunity and Insider Trading. *Northern Illinois University Law Review*. Volume 10. No. 1. 2-35. [Online] available from: http://www.walterblock.com/ wp-content/uploads/publications/information_privilege.pdf. [Accessed: 11 December 2014].

[614] See, in general, Rider et al. (2009)*'Market Abuse and Insider Dealing'*, *supra* note 395 at 163-166. However, the fiduciary duty in the UK falls only on the primary insider toward the company. Hence, the shareholders of that company do not have this duty. Percival v Wright [1902] Ch 421. See, e.g., Rider, B. & Ashe, M. (1993) *Insider Crime: The New Law*. United Kingdom: Jordan Publishing Limited. 67; Brazier, G. (1996) *Insider Dealing: Law and Regulation*. United Kingdom: Cavendish Publishing Limited. 89-90; and Avgouleas, (2005) *'The Mechanics and Regulation of Market Abuse…'*, *supra* note 98, at 432-434.

[615] Comeau, M. N. (2006) The Hidden Contradiction Within Insider Trading Regulation. *University of California Los Angeles Law Review*. Volume 53. 1275, 1280.

The FCA has defined several types of conduct that can be termed as market abuse and they include: [616] insider dealing,[617] improper disclosure,[618] misuse of information,[619] manipulating transactions,[620] manipulating devices,[621] dissemination,[622] and any other behaviour that likely gives a regular user a false or misleading impression with regard to the market orders (supply and demand orders), value, or price of a qualifying investment; or would, or would be likely to destroy the market in the view of the regular user.

No doubt there is a fine line separating each of these types of market abuse described above. However, the UK has used different approaches for prohibiting market manipulation. The law uses specific wording to cover the widest possible range of practices of market manipulation. It prohibits any course of action that may lead to deception of investors or that may create false impression, or cause the creation of an improper appearance relating to the demand or the supply or the value of an investment.

In addition, the FCA Handbook seeks to carefully define and outline the rules relating to market conduct and market manipulation. All member firms are required to follow the FCA's Conduct of Business Handbook requirements as well as appoint competent and experienced compliance officers to oversee the function.[623] The Market Conduct Source book (MAR) sets out these rules and regulations.[624] MAR is divided into two sections, namely, the

[616] Section 118 of the UK FSMA 2000, *supra* note 163. Previously, before the amendment of 2005, the FSMA 2000 dealt in section 118 with three forms of illegal behaviour, namely misuse of information, false or misleading impression, and market distortion. The FSMA 2000 was amended later to covers all activities that may affect and harm integrity and the confidence of the financial system in general, regardless of the offender's identity or position. In addition, the new regime was civil in nature to work together, as a supplement law, with the Criminal Justice Act of 1993 in prosecuting, inter alia, the offence of insider dealing, and it was designed to fill the lacuna that had appeared in the previous laws. See Rider et al. (2009) *Market Abuse and Insider Dealing*, *supra* note 395, at 71; and Alexander, K. (2001) Insider Dealing and Market Abuse: The Financial Services and Markets Act 2000. *ESRC Centre for Business Research University of Cambridge*. Working Paper No 222. December 2001. [Online] available from: http://www.cbr.cam.ac.uk/pdf/WP222.pdf. [Accessed: 10 December 2014]. See also the Financial Services and Markets Act 2000, *supra* note 163.

[617] When an insider deals or attempts to deal in investments on the basis of inside information relating to the investment in question. See the Financial Services and Markets Act 2000, *supra* note 163.

[618] When an insider discloses inside information to another party (parties) in violation of the employment, profession or duties functions. *Ibid*.

[619] When a person or a group of people act on the basis of information not available to the public, but if it were available, would or would be likely to have a material effect on the investment decision of a regular user. *Ibid*.

[620] When a person (or a group of persons) creates artificial, false or misleading appearances in respect of one or more qualifying investments. This activity usually takes place when: (a) a person (or group of persons) creates or is likely to create a false or misleading appearance of active trading (supply and demand) in one or more qualifying investments; or (b) a person (or group of persons) artificially to raise or decrease the market price of one or more qualifying investments to secure the price at an anomalous or artificial level. *Ibid*.

[621] Where a person uses fictitious means or any other type of deception or contrivance to influence the decisions of investors. *Ibid*.

[622] Where a person (or group of persons) employs any devices to disseminate false information or a misleading impression when he knows or reasonably should know that the information was false or misleading. *Ibid*.

[623] In a financial service firm, compliance is the function of identifying relevant legislative, regulatory and best practice requirements and implementing the necessary arrangements, systems and controls so as to facilitate adherence to these obligations. See Mills, A. (2008) *Essential Strategies for Financial Services Compliance*. United Kingdom: John Wiley and Sons Ltd., 7, 12, 18

[624] See Fca.org.uk (2013) *The Market Conduct Source book (MAR)*. [Online] available from: http://www.fca. org.uk/firms/markets/market-abuse/market-conduct. [Accessed: 20 April 2014].

Code of Market Conduct (known as MAR1)[625] and the Price Stabilising Rules (known as MAR 2).[626] Moreover, enforcement plays a vital role in the UK to ensure that insider dealing does not occur. In 2012, the FCA raised UK£312 million in fines alone, a huge number considering that the previous record high for fines collected in one year was UK£89 million. Since 2009, the FCA has successfully sought and received 23 insider dealing convictions with another two cases charged in 2013.[627]

There is, however, a potential inconsistency of policy in advocating more effective engagement between companies and investors, and at the same time prohibiting investors from deriving financial advantage from such engagement beyond the limited extent that such engagement benefits all holders of stock. Considering the strong emphasis on market conduct, an increasing emphasis on shareholder dialogue and the move to a new regulatory regime under the FCA, it would be logical for a dialogue to be opened between the new regulator and investors about ensuring that these two policy objectives namely, shareholder engagement and market abuse prevention remain aligned. This may increase market confidence and lead to better outcomes.

Thus, policing the capital markets has become a tremendously complicated task that requires high-tech and cutting edge information technology. Today, the FCA is able to run highly complicated, sophisticated and covert operations against any licensed individuals and firms that may be involved in insider dealing as well as team up with other governmental and law enforcement agencies (both local and international) to ensure that perpetrators are swiftly brought to justice.[628]

In KSA, the CML and the CMA oversee and prevent malpractice within the equity market. The CML provides two different routes for disputes leading to the CRSD depending on the nature of the complaint. The first is where an investor is willing to bring an action against a licensed broker. A complaint should start at the exchange (Tadawul), which enjoys the jurisdiction of settling disputes among members of the Exchange and between the members and their clients. The CMA has published a non-exhaustive list of disputes within Tadawul's jurisdictions, including problems in executing an order placed by a customer, refusal to provide brokerage services to a customer, or mismanaging a customer's account on technical grounds. The CMA permits investors to make complaints electronically through the CMA's website.[629]

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[625] The Code of Market Conduct (MAR 1), *supra* note 333.
[626] The Price Stabilisation Rules (MAR 2), *supra* note 413.
[627] For the FCA tables of fines, see *supra* note 529.
[628] See Brooslin, A. S. (1997) Enforcing Insider Trading Laws: The Need for International Cooperation. *Suffolk Transnational Law Review*. Volume 22. Issue 2. 399-400; Baltic, C.V. III (1992) The Next Step in Insider Trading Regulation: International Cooperative Efforts in the Global Securities Market. *Law & Policy in International Business.* Volume 23. Issue 1. 184; Greene, C.A. (1994) International Securities Law Enforcement: Recent Advances in Assistance and Cooperation. *Vanderbilt Journal of Transnational Law*. Volume 27(3). 665; and Kehoe, J. A. (1995) Exporting insider trading laws: the enforcement of U.S. insider trading laws internationally. *Emory International Law Review*. Volume 9. Issue 1. 346.
[629] Cma.org.sa (2014) *How To Make A Complaint*. (CMA publication No.11). 4-5. [Online] available from: http://www.tadawul.com.sa/static/pages/en/InvestorGuide/PDF/IG_11.pdf. [Accessed: 10 August 2014].

Inevitably, there are some overlaps between the jurisdictions of Tadawul and the CMA with regards to investor complaints. The CMA indicates that it would reject any complaint submitted which is within the jurisdiction of Tadawul, and requires investors to submit initially a request to Tadawul in case of any doubt as to the appropriate authority to consider a dispute.[630] On proper examination, both the CMA and Tadawul routes are merely informal means to settle disputes since an investor lodging a complaint with Tadawul or the Authority still enjoys the right to bring an action before the CRSD if the complaint is not solved within a period of time by agreement between the investor and the service provider. The difference between the two routes is that the CML states that the CMA is not permitted more than ninety days to consider a complaint otherwise an investor can bring an action directly to the CRSD.[631] In contrast, the CML is silent as to the limit of time that Tadawul is permitted in considering a complaint. However, since the CMA is a higher authority, it could be reasonable to argue that what binds it should also be binding on the exchange, and thus there should be limited period of ninety days.[632]

It is vital that both market members and market participants, including investors have correct and functional channels within which to seek legal or institutional recourse. The CRSD's stated objectives are to ensure the "protection of investors against unfair or incorrect practices or any acts that involve fraud, deceit or manipulation,"[633] and as such the CML empowers the CRSD to investigate and settle disputes that may occur including the imposition of sanctions and penalties. The preceding description shows that the judicial institutions having jurisdiction to deal with securities litigations are independent of the government. The CML of 2003, as the sole securities legislation, has created the securities courts and defined the jurisdictions of those courts. The courts have both civil and criminal jurisdictions. These courts are empowered by the CML to set appropriate compensation and penalties in all cases brought before them, as stipulated in the pertinent laws. Moreover, these specialised courts have absolute jurisdiction over securities cases.[634]

However, as previously indicated, the quality and effectiveness of the judiciary is significant for successful enforcement of securities laws. Thus, there is a real need for securities law schools, experts and more research in order to enrich the securities knowledge of judges and lawyers. Furthermore, the role of the CMA as the regulator of the market has to be more effective. Issuing rules and regulations to foster the confidence in the market should be a fundamental task of the CMA.[635] Clearly, better functioning of judicial enforcement

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630 Alabdulkarim, S. (2012) An Evaluation of Investor Protection in Secondary Securities Markets A Comparative Study of Regulatory Regimes in the United Kingdom and Saudi Arabia. *PhD Thesis*. United Kingdom: Newcastle University. 276.

631 Article 25(e) of the CML, *supra* note 2. See also Article 2 of the Procedures of Resolution of Securities Disputes (PRSD) under resolution No (01-04-2011) dated 19/02/1432H corresponding 23/01/2011 to, pursuant to the Capital Market Law issued by the Royal Decree No (M/30) dated 02/06/1424H, corresponding to 31/07/2003.

632 Alabdulkarim, S. (2012) *'An Evaluation of Investor Protection…'*, *supra* note 630, at 276.

633 See Article 25 of KSA Capital Market Law of 2003, *supra* note 2. See also the CRSD vision, mission and goals, *supra* note 421.

634 Alanazi (2012) *'Investor Protection and the Civil Liability…'*, *supra* note 5, at 298.

635 *Ibid*., 337.

requires an appropriate legal framework that encourages the objective enforcement of laws and pertaining regulatory framework.

Strong legal framework and efficient courts prevent illegal practices, benefits market participants, and thus deter disasters in financial markets. In other words, 'weak legal institutions can contribute to economic crises.' [636] However, the effectiveness of each court's operation is important in order for it to be able to dispense justice and maintain confidence amongst market participants. Many have argued that the quality of justice is measured by the quality of judges.[637] It is not just a matter of what penalties are available, but of the willingness of the judiciary to impose them. It is also a matter of the training received for the extensive responsibilities that they bear. The members of the securities courts in KSA have broad powers ranging from imposing monetary penalties to imprisonment.[638]

It has been confirmed that in business transactions, the remedy of account of profit is significantly useful.[639] The situation in KSA, however, requires a clear mechanism to distribute the gains resulting from the law violations to all investors who sustain loss or damage as a result of that violation, rather than simply allowing them to accrue in the accounts of the CMA for its own use. Indemnification of injured investors will increase investor confidence in the securities market by fostering the protection of investors.[640]

In brief, it is suggested that reforms of the judiciary are required to effectively deal with cases arising in the securities market. In addition, amendments are required to be made to Article 25 of the CML of 2003. This is because this Article governs the formation and the criteria for the selection of members of the CRSD and ACRSD. The law is required to be properly enforced; for this it requires more courts and judges and greater assurance of judicial independence. Equally important, it is necessary for a statutory securities class action to be available to the general investor to provide better protection. The interpretation of the sanctions and remedies of Article 59, especially with the enforcement of civil liability provisions is also necessary.[641]

Notably, in 2004, the CMA expanded on the insider trading provisions contained in the CML by issuing a Market Conduct Regulation to define"insiders", and prohibit illegal direct and indirect insider trading, as well as market manipulation. Moreover, the CMA has taken action against insider trading, and results have been published on its website.[642]

In the UAE, the Federal Law No. 8 of 1984 Concerning Commercial Companies provisions represent an insufficient means to define all the acts of market abuse, particularly in the securities markets. Therefore, the UAE financial markets need to develop a highly

[636] Johnson S. (2002) *'Coase and the Reforms of Securities…'*, *supra* note 390, at 13.
[637] White, P. J. (2002) Judging Judges: Securing Judicial Independence by Use of Judicial Performance Evaluations. *Fordham Urban Law Journal*. Volume 29. Issue 3. 1053, 1064.
[638] Reuters.com (2009) *'Saudi Court Gives First Jail Term for Stock Market ...'*, *supra* note 423.
[639] McGlone, F. & Stickley, A. (2009) *Australian Torts Law*. 2nd Ed. Australia: LexisNexis Butterworths.
[640] Alanazi (2012) *'Investor Protection and the Civil Liability…'*, *supra* note 5, at 326-27.
[641] *Ibid*., 336.
[642] Worldbank.org (2009) *'Saudi Arabia: Corporate Governance Country Assessment…*,' *supra* note 345, at 3. See also CMA Market Conduct Regulations, *supra* note 227.

structured and efficient legal system to deal with securities market malpractices. Not only the regime dealing with market abuse and other improper conduct is weak in the financial markets, there are some vague areas that the regime needs to remedy, reconsider and reform the UAE legislation.

The legislation should pay attention to preventive measures by criminalising all forms of market abuse. It needs to define these illegal practices rather than leave them as vague and in general terms. It needs to cover in detail elements of insider dealing and market manipulation. If this is achieved, reasonable protection for investors will be provided. It is due to the complexity of this offence, in most of the insider dealing cases, that there is difficulty in distinguishing between legal and illegal behaviour. For instance, in the case of trading based upon non-public information, the measures of materiality or sensitivity, precision, and publicity of such information present a significant challenge for investigators and judges in the UAE to establish the precise links between the legal elements of this crime. As a result, the elements of the crime have not been defined in either the SCA Law 4 of 2000 or the SCA consequent regulations. Hence, the vagueness of the elements of insider dealing in the UAE, and the means involved in committing it can raise its complexity.[643]

The courts and legislatures in the UK have been confronting this offence for many decades, while the UAE has not yet begun to exercise investigative power. In the UK, the laws of the securities market that govern the offence of insider dealing require several elements to ascertain the legitimacy of the behaviour of any person who traded on the inside information. When such factors are confirmed, it could be safely determined that the person's activity was illegal. These factors include:[644]

- The trading occurred based upon material precise undisclosed information;
- The trading took place during the time when the person possessed material nonpublic information; and
- The person who made the transaction obtained such information as a result of a confidential relationship, directly or indirectly, or a trust duty, which was violated by carrying out such trading. In other words, the information was misused.

Although the SCA issued several decisions to monitor and control stock market operations and to prevent any violations of its Law No. 4 of 2000, it has not presented a comprehensive decision regarding the practice of insider dealing and market abuse. Meanwhile, in the existing law, only two provisions, provisions 37 and 39, relate to insider dealing. These provisions are inadequate to safeguard market integrity and to protect investor interests.[645] Articles 37 and 39 have prohibited exploiting inside information but did not characterise this information. There is no particular requirement that inside information should be specific or precise. The above Law also did not require that inside information

[643] See Alhamrani (2011) *'Insider Dealing In the Stock Market…'*, *supra* note 441; and Albelooshi (2008) *'The Regulation of Insider Dealing…'*, *supra* note 251; and Al Shamisi (2010) *'Investigation into Market Abuse in the UAE…'*, *supra* note 438.
[644] Section 56 of the UK CJA 1993, *supra* note 393; and Section 118C of the FSMA 2000, *supra* note 163.
[645] See Alhamrani (2011) *'Insider Dealing In the Stock Market…'*, *supra* note 441; and Albelooshi (2008) *'The Regulation of Insider Dealing…'*, *supra* note 251.

should be relevant to particular securities or to an issuer of securities. Both of these requirements (precise and relevant to) are omitted by the UAE law, which contrast to the UK laws. Hence, it is strongly recommended to amend this Article to add the requirement that inside information should be specific or precise and relevant to particular securities or to an issuer of securities. Therefore, the SCA should promulgate new rules and regulations, as the FCA has done by issuing the Market Conduct Source book (MAR) [646] to clarify and determine, the legal elements of insider dealing and market abuse and their scope, based on the provisions of the FSMA 2000.

Furthermore, the UAE regulator has not provided an adequate and comprehensive definition of 'insider', in contrast to the UK laws. Although, Article 39 [647] of the law defines an insider as 'any person,' the SCA Regulations of 2000 limited the scope of this Article by providing that 'any person' must obtain the inside information by virtue of his position. In this sense this law did not include secondary insiders under this Article. Therefore, this Law must be modified and the penalty must be imposed upon both the person who is 'procuring' or 'encouraging' others to deal and who has been procured or encouraged by insiders, and also who leaks inside information and who has received it if he used the information.[648] Not only the definition should include those who have access to the inside information of an issuer by virtue of their employment, profession or activities. In addition, the term 'position' has a special meaning in the UAE culture as referring to one who is usually on the top of the hierarchy in entities and also has a different meaning in Arabic than it is in English. This creates a loophole in the legislation which may reflect the inability to successfully prosecute.[649]

Undoubtedly, the UAE can learn from the expertise of the UK in securing its securities markets from insider dealing as a type of market abuse. In the UK, the three forms of insider dealing are criminalised, including trading on the basis of material, non-public information, disclosing or tipping such information to others, and encouraging others to trade on such information. In contrast, in the UAE, the form of trading is criminalised, while the acts of disclosing to or encouraging others are not considered within the scope of the insider dealing provisions. In addition, to accuse a person of the crime of trading on the basis of material, non-public information, the prosecution must prove that the person gained personal profit from the transaction. Therefore, the UAE legislation should widen its scope in order to criminalise the action of using inside information without requiring 'personal benefit.' As soon as an action is taken a crime has occurred since it is against the rule of equality and fairness between the investors with regard to access to inside information. These two issues create a legal loophole for the prosecution of offenders, which would make breaches of the insider dealing provisions more defensible.

[646] The Market Conduct Source book (MAR), *supra* note 624.
[647] Article 39 of the SCA Federal Law of 2000 states that: "It shall not be permitted for any person to deal in Securities on the basis of unpublicised or undisclosed information he acquired by virtue of his position...", *supra* note 75.
[648] Al Shamisi (2010) *'Investigation into Market Abuse in the UAE…'*, *supra* note 438, at 317.
[649] *Ibid*., 190.

The SCA Law of 2000 should further provide criminal liability for the legal person who may commit insider dealing. It also should enhance the punishments for insider dealing that are set under this Law. According to Article 41,[650] any person found guilty of violating the provisions of insider dealing shall be liable for a penalty of not less than 100,000 Dirhams (approximately UK£ 16,500) and not to exceed 1,000,000 Dirhams (approximately UK£ 165,500), or imprisonment for a term of not less than three months and not to exceed three years, or both. Assuming that an insider has gained more than 10 million Dirhams from the act of insider dealing, he will be required to pay a fine of 1,000,000 Dirhams or less, which is not likely to achieve the deterrent effect. In other words, if the punishment is not severe enough, it will not deter individuals who are most likely to commit insider dealing. Especially that in the UK, pursuant to Section 61 of the CJA 1993, any person who commits the crime of insider dealing is punishable on summary conviction by a fine of up to the statutory maximum or/and imprisonment for any term not exceeding six months. Moreover, there is no limit on the fine that can be imposed upon conviction on indictment or imprisonment for a term not to exceed seven years or both.[651]

Moreover, the courts must be empowered to order any offender to disgorge what he gained from the offence of insider dealing to those injured by his or her abusive behaviour. These criminal penalties should be applicable to both natural and legal persons. Notably, not only the UK legislation empowered the FCA to disgorge the profits obtained by insider dealing from the wrongdoer to the company in question, but that also applies even if he was a secondary insider (tippee). Under the authorisation of Section 383 of the FSMA 2000, the FCA has the power to order, through the court, any offender to disgorge what he gained through illegal insider dealing to those injured by such dealing.[652]

The UK Parliament, as the legislature, has regulated the fate of the contract rather than leaving it to the discretion of courts. The English law expressly requires that the doctrine of illegality be excluded at common law. That doctrine stipulates that a contract will be void and unenforceable if it is illegal or concluded through the commission of a crime. In other words, under the common law, the court held that no person shall be allowed to benefit from his own crime. In addition, the reason behind these sections is the difficulty of tracking the transactions concluded through the illegal use of inside information, along with the problem of identifying the contracting parties' identity.[653]

Hence, because institutional companies dominate trading in the securities market, while individual traders are gradually diminishing, it is vital to impose a criminal penalty on legal persons by enacting a law that holds them directly liable for violating the securities market law. The law should authorise the SCA to order the payment of civil penalties as well as disgorgement, as is done through the legal framework of the UK. Further, the SCA, as the financial regulator, should be given broad powers of authority to investigate and prosecute

[650] Article 41of the SCA Federal Law No. (4) of 2000 Concerning Emirates Securities, *supra* note 75.
[651] Legislation.gov.uk (2012) *The Criminal Justice Act 1953, Section 61, Penalties and prosecution.* [Online] available from: http://www.legislation.gov.uk/ukpga/1993/36/section/61. [Accessed: 13 August 2012].
[652] The Enforcement Guide, *supra* note 457.
[653] Cleaver v Mutual Reserve Fund Life Association, [1892] 1 QB 147, 156. See also Avgouleas, (2005) *'The Mechanics and Regulation of Market Abuse…'*, *supra* note 98, at 429.

insider dealing and market abuse. Meanwhile, the law should criminalise action that might hinder or impede investigations and law enforcement. Moreover, the concept of a Chinese wall[654] policy should be introduced in the UAE markets by law in the same way as the UK framework to prevent the inappropriate flow of material, non-public information, thereby reducing the chances of committing insider dealing.

The difficulties that arise from proving, preventing, detecting, and controlling insider dealing activity, which are faced in the UK market, must be borne in mind. Further, the mechanisms utilised to overcome these issues should be considered. Hence, the SCA investigators should be well qualified and acquainted with the manner of investigations which the FCA investigators use and should be aware of the methods available to fight such a complex crime. They should be provided with sufficient investigation tools to enable them to detect and prove insider dealing easily with minimal cost and effort.

Therefore, developing the skills of market abuse policing teams and prosecutors should be a priority of the UAE government. The investigative authority, even the judges concerned with this kind of crime, also need such training in the technical methods used to commit insider dealing and market abuse. In addition, the investigating teams must have the skills of detecting suspects and assembling, examining, and securing incriminating evidence. They must also keep current in their preparedness with regard to new manners of committing market abuse and insider dealing. The effectiveness and efficiency of the investigation team should be enhanced through professional training programs and joint seminars and workshops in the area of securities market crimes.

Additionally, the SCA should be able to disqualify company directors and officers who have been convicted of, or pleaded guilty to, the offence of insider dealing. The law should empower the authority to do so, and not leave it to the courts. It is obvious, therefore, that the disqualification penalty is a valuable instrument in the developed markets, such as those in the UK, for deterring insider dealing and securing the integrity of the market. Accordingly, that instrument should be given to the SCA to enable it to carry out its roles in preventing and combating insider dealing in a very effective manner.

Although the offence of insider dealing can lead to criminal and civil penalties, it provides with a number of defenses. The legislature of the UK has realised that many persons

[654] "Chinese wall" is a phrase used in the securities markets to refer to an information barrier within a company or multi-service financial institutions to prevent sensitive nonpublic information from being exchanged between the different departments within the company ambit. See Varn, L. L. (1984) The Multi-Service Securities Firm and the Chinese Wall: A New Look in the Light of the Federal Securities Code. *Nebraska Law Review*. Volume 63. Issue 2. 197-99. Notably, listed companies should be required to list the names of insiders within the company and identifying their transactions in the company's securities to prevent such persons from trading on material non-public information and to give regulators an opportunity to monitor their trading activities closely. See Fca.org.uk (2014) *FCA Disclosure Rules and Transparency Rules (DTR), Disclosure and control of inside information by issuers (DTR 2).* [Online] available from: https://fshandbook.info/FS/html/FCA/DTR/2. [Accessed: 22 November 2014]. In the opinion of the FSA, if a company keeps its sensitive non-public information away from individuals who are involved in or who influence the decision to trade by using an effective Chinese wall or similarly effective arrangements, then the decision to deal by the company will not be considered to have been based upon inside information. See Rider et al. (2009) *'Market Abuse and Insider Dealing…', supra* note 395, at 178-83.

who act in good faith can be affected by the generalisation of the prohibition of insider dealing. Accordingly, while the Emirati legislation has not provided any specific defenses to the charge of insider dealing, the UK regulations contain safe harbors against such a charge. The CJA 1993 and FSMA 2000 contain defenses that can protect any person who possesses price sensitive information that are not generally available, against being charged for insider dealing. Hence, the existence of a legitimate justification for trading in securities by someone who knows material non-public information opens the door widely to a successful defence against the charge of insider dealing. In contrast, in the UAE, no statutory defenses protect investors if the element of good faith is present.

Furthermore, the CMA and the SCA need to empower their respective enforcement departments or units as well as the customer complaints divisions whose objective is to bring reparation to aggrieved parties. Moreover, the SCA regulations need to provide for strict punishments, for those market participants who breach the rules as previously indicated. Since prevention is always better than attempting to correct after the occurrence, it is in the best interests of both KSA and the UAE financial regulators to ensure that strict enforcement measures are in place to prevent these types of behavior.[655]

In addition, the general awareness of the securities market laws and regulations amongst the investing public should be developed. The majority of local investors in the financial markets of KSA and the UAE are unfamiliar with investing in the securities market. They get involved in the securities market without knowledge or understanding of the processes of investments. They just want to maximise their return without understanding the consequences. Investors need real knowledge of sophisticated financial instruments and understanding of electronic commerce. It is the responsibility of both countries' regulators to spread awareness and knowledge amongst investors.

The SCA also has a dedicated complaints and appeals system run by the Enforcement and Follow up Department of the SCA which deals with all issues related to transaction executed in the markets. As per the federal UAE regulation, the financial authority must have a system to receive and equitably deal with investor complaints. Article 11 of the Regulations of Market Licensing & Supervision [656] specifies that the Authority shall accept complaints made relating to the investors and brokers as well as follow through with necessary investigations.

The complaint system is online and must be written and relate to securities or commodities transactions executed on either or both the DFM and the ADX. The SCA is obliged to contact the complainant within five (5) working days [657] after which all necessary steps including the required documentation are collected and examined. The SCA estimates

[655] Abu Shehab, S. (2014) The National Council's Finance Committee call for an end to problems delaying the integration of the two markets. *Alkhaleej*. 30 October 2014. [Online] available from: http://www.alkhaleej.ae/economics/page/68dffc5c-dc5d-48fb-b7a7-864715b04389. [Arabic]. [Accessed: 22 November 2014].

[656] Sca.gov.ae (2014) *Markets Licensing and Supervision Regulations*. [Online] available from: http://www.sca.gov.ae/English/legalaffairs/Documents/2000-11.pdf. [Accessed: 20 November 2014].

[657] Sca.gov.ae (2014) *Complaints Appeal System*. [Online] available from: http://www.sca.gov.ae/English/services/Investors/Pages/ComplaintsAppealsSystem.aspx. [Accessed: 20 November 2014].

that it takes anywhere between 2-12 weeks to resolve and complete a complaint. In the event that a complaint takes the form of arbitration, investors have the option to seek legal redress as well in accordance with Regulations for Arbitration as specified in Article 4 of the Federal Law of the Emirates Securities & Commodities Authority and Market.[658]

A complainant must fill in an application form and pay an arbitration registration fee of 1,000 Dirhams (US$275) as well as pay a fee of 3,000 Dirhams towards the administrative costs entailed in pursuing legal action. The complainant must also show documented evidence of the wrong doing as well as breakdown of compensation sought from the accused. The SCA estimates that the procedures for all administrative work will take about 10 days in order to appoint a court judge to oversee the case with an additional 5 days post appointment to ensure that the judiciary is fully updated with all the relevant paperwork and case details. Evidence, unlike KSA on the efficacy of the court is thin since the SCA does not publish these cases. As mentioned previously, the CMA has taken a new stance by ensuring that wrong doers are 'named and shamed' whereas this is still not yet the case in the UAE.

Generally, the SCA and the securities markets roles in preventing market abuse are not distinctly defined and there is a multiplicity and overlapping of jurisdiction between the SCA and these markets. It is therefore proposed that the UAE establish a specialist court in the financial market, introduce the concept of criminal reconciliation, and publish offenders' names and proportional fines.

Insider dealing has become eminent in the world today, the reason why reforms in the form of regulations were put in order so as to address and dissuade it through the enforcement methods of regulators in imposing civil or administrative fines. The UK is one of the key countries by which the said reform has implemented and enforced. The UK government has traditionally placed its confidence on simply applying criminal sanctions, which resulted to a low rate of successful prosecutions on cases regarding insider dealing. In order to tailor and provide an efficient system that will enable insider dealing cases to be handled legally and successfully, the UK has established the FSMA 2000 under the civil or administrative administration. Therefore, it can be said that the current trend in regulation is to establish an empowered administrative system in order to deal with insider dealing and market abuse.

The practical reason underlying such a trend is that proof in a civil/administrative case is easier than in a criminal case. It can be observed, especially from the UK experience, that an administrative regime is more efficient than a criminal regime. Therefore, it is recommended to introduce a civil/administrative system to deal with insider dealing and other market misconduct. An administrative regime in which the regulator has powers to impose civil penalties on insider dealers is believed to be more practical. Adequate authority should be delegated to the SCA in order to enable it to introduce rules, supervise markets, and investigate and prosecute insider dealing.[659]

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[658] Article 4 of SCA Federal Law No. (4) of 2000, *supra* note 75.
[659] Albelooshi (2008) *'The Regulation of Insider Dealing…*', *supra* note 251, at 306-07.

It is worth indicating that in the last few years, the SCA has clamped down on insider dealing by approving and passing a series of measures to check and curtail insider dealing and share price manipulation by issuing new regulation. As part of these regulations, senior management of listed companies including chairmen, board members, general managers and other employees who are privy to price sensitive information have been barred from trading in the company's or its subsidiaries' shares.[660] The new regulations defined the SCA's regulatory role over the securities markets and lay down conditions for obtaining licenses and regulatory approvals as well as compel any person believed to be engaged in suspicious activities to disclose relevant information which could, in any way influence, share prices.The SCA board also approved an amendment to Article 37 of its Resolution on Disclosure and Transparency by adding a clause, referred to as Clause 2, to empower the board of directors to levy fines on any investor and/or suspend him from trading shares for a period of not more than one year from the date of suspension.[661]

## 7.5 Suggested Approaches to False Accounting

It has been proved how false accounting can has tremendous negative impacts on the capital markets. These impacts are affecting the strategic objectives for any regulatory body which are: investors' protection, markets' efficiency and confidence, disclosures and corporate governance structure. Therefore, we had seen many initiatives from regulators worldwide to increase the level of controls and prevent false accounting from happening, whether it was by intention or as a result of negligence and not conducting the necessary fiduciary duty. These efforts by the regulators are challenged by the fact that companies' financials nowadays are no more that simple, accounting treatments can be manipulative if they are misused by the companies, taking into consideration the complexity of companies' financials due to the complexity of business itself.

The UK's experiment in this regard considered to be one of the first initiatives since long time. The primary financial legislation that attempts to address the matter of false accounting relates to the Theft Act of 1968.[662] The Act has addressed the false accounting matter clearly through defining and criminalising it, and stating the legal consequences for such practice, as it will be explained in the first recommendation below. On the other hand, the UK considered one of the leading countries in promoting the accounting profession and enhancing the auditing culture through establishing various professional bodies to be considered as references for the accounting and auditing industry, this includes associations

[660] Article 37 of the SCA Regulations as to Disclosure and Transparency, *supra* note 275.
[661] Khaleejtimes.com (2005) *ESCA clamps down on insider trading. 8 November 2005.* [Online] available from: http://www.khaleejtimes.com/DisplayArticle09.asp?xfile=data/business/2005/November/business_November148.xml&section=business. [Accessed: 10 November 2014].
[662] Legislation.gov.uk (2014) *The Theft Act 1968*. [Online] available from: http://www.legislation.gov.uk/ukpga/1968/60/contents. [Accessed: 6 May 2014].

and institutes.[663] Having all these associations will boost the standards in the accounting and auditing professions, which leads to better accounting treatments and framework through ensuring the appropriate of level competency and professional integrity.

Another aspect of UK's initiatives in this regard is the role of the audit committees, which considered a key internal function that aims to prevent false accounting and fraud from occurring and ensure that false accounting and fraud are kept to a bare minimum. Therefore, directors of an audit committee are considered independent to the company itself in the UK. Furthermore, corporate governance codes have been established for UK listed entities to ensure that senior management and board members have the correct internal systems in place that would prevent false accounting from occurring. The importance of document management in combating and suppressing accounting fraud cannot be understated as well as other matters related to the general duties and responsibilities of directors including financial reporting and accounting responsibility. The strict penalties imposed by the FCA including large penalties, withdrawal of a licensed persons status as well as subsequent loss of reputation are deemed sufficiently substantial to work as a barrier towards a criminal offence taking place.[664]

In KSA, measures used to prevent concealment or falsification of records and documents is not specifically referred to in the CML but there are several other methods by which the Authorities can suppress this activity. Similar to the UK, requirements for correct internal risk management procedures as well as stiff fines serve as potential preventatives. The CMA Board also has the power to suspend and withdraw licenses from approved persons in the event a breach has occurred. However, adherence to a systematic and streamlined global accounting standard such as the IFRS is a key issue that both the CMA and SAMA are still in the process of implementing in KSA and will go a long way in helping to uncover any fraud or accounting irregularities.[665] The establishment of Saudi's Organisation for Certified Public Accountants "SOCPA"[666] considered one of the early initiatives that the Kingdom has in regards to strengthening the accounting profession through consolidating the accounting references used by KSA firms. Yet, there are no clear

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[663] To name few: The Association of Chartered Certified Accountants "ACCA" which has around 170,000 members (Accaglobal.com (2014) *The Association of Chartered Certified Accountants*. [Online] available from: http://www.accaglobal.com/uk/en.html. [Accessed: 28 December 2014]); and the Institute of Chartered Accountants in England and Wales "ICAWE" which has more than 142,000 members Icaew.com (2014) *The Institute of Chartered Accountants in England and Wales*. [Online] available from: http://www.icaew.com/. [Accessed 28 December 2014]). Other professional bodies include and not limited to: The British Accounting and Finance Association "BAFA" (Bafa.ac.uk. (2014) *British Accounting and Finance Association "BAFA*." [Online] available from: http://bafa.ac.uk. [Accessed: 28 December 2014]); the Association of International Accountants "AIA" (Aiaworldwide.com. (2014) *Association of International Accountants "AIA*." [Online] available from: http://www.aiaworldwide.com. [Accessed: 28 December 2014]); and Certified Public Accountants Association "CPAA"(Acpa.org.uk (2014) *Certified Public Accountants Association "CPAA"*. [Online] available from: http://www.acpa.org.uk/. [Accessed: 28 December 2014]).

[664] See the Theft Act 1968, *supra* note 662.

[665] Iqbal, M. A. (2012) *Saudi Accounting Framework in comparison with IFRS Framework.* [Online] available from: http://www.icapksachapter.org/wp-content/uploads/presentation/ICAP_Chapter_CPD_Khobar.pdf. [Accessed: 20 August 2014].

[666] *Ibid*. See also See Socpa.org.sa (2013) *Saudi Organisation for Certified Public* Accountants, *supra* note 236.

indicators about the initiatives and the impacts of SOCPA in KSA and how it can be utilised to minimise false accounting cases or even attempts.[667]

In UAE, there were many initiatives in the last years due to the share of false accounting and fraud cases which the country had as a result of lax regulation, weak enforcement and especially a market perception that perpetrators are insufficiently punished for their crimes. This perception of poor retribution is, in the researcher's view, endemic to the region. The credit crisis in the UAE resulted in increased scrutiny being exercised over many government-related entities due to the realisation by authorities that several high-profile government figures and business executives were benefiting illegally from the misappropriation of public funds. This prompted the Ruler of Dubai to issue Dubai Law of 2009 on the recovery of public funds and money collected illegally.[668] It also provides for the imprisonment of those that benefited illegally, with the opportunity for the culprit to reduce or escape a prison sentence where they reimburse the illegally appropriated funds. Further, in 2010 another Dubai Law was issued on the Audit Finance Department. The Law grants the Department extensive powers over government entities and any company in which the government of Dubai holds 25% or more of the shares. As to corruption, Article 19(9) of the Law is very clear: "accepting or requesting [a] bribe... abuse of position, unlawful earning, [or] conflict of interest" constitutes a "financial violation" under the Law, where such an act is committed by an official or employee of entities within the Department's scope.[669]

Some of the key steps that had been taken by the financial regulator in the UAE, have led to an overall improvements in relation to the disclosure requirements as well as the implementation of the sound corporate governance practices. These regulatory provisions include structure of boards, separation of the role of CEO from that of Chairman, requirements for strict internal controls as well as risk management systems.Companies are also required to produce annual compliance reports detailing the actions taken as well as preventative measures to combat and uncover malpractices within their respective organisation. Unlike the UK, the corporate governance code in the UAE is mandatory and non-compliance will result in penalties being imposed. The imposition of such penalties is envisaged to act as a preventative measure to ensure compliance with sound corporate governance practices. The requirement that each board of director of listed entities initiate and establish effective internal controls coupled with the annual compulsory external audit act as further backstops in the fight against fraud.

The current legal and regulatory framework oblige the listed companies to provide an audited and reviewed financial statements annually and quarterly respectively, these statements should be disclosed within the regulatory timelines. Furthermore, companies are obliged to provide fair financial statements, however, this framework shall be strengthen

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[667] Worldbank.org (2009) *'Saudi Arabia: Corporate Governance Country Assessment*…,' *supra* note 345, at 5, 17.

[668] Theuaelaw.com (2014) *Dubai Law No. (37) of 2009 on Procedures for the Recovery of Illegally Obtained Public and Private Funds*. [Online] available from: http://translate.google.ae/translate?hl=en&sl=ar&u=http://theuaelaw.com/vb/showthread.php%3Ft%3D549&prev=search. [Accessed: 20 August 2014].

[669] Arablawsworld.com (2014) *Law No. (8) of 2010 on the Financial Audit Department*. [Online] available from: http://www.arablawsworld.com/dubai-local-laws.php?page_number=96. [Accessed: 20 August 2014].

through the criminalisation of all false accounting cases, and provide the SCA with the necessary legal authority to pursuit all related parties in such cases, this include companies' auditors, too, and take strict legal actions in these cases.

Another regulatory development needed to empower the SCA being the capital market regulator is to conduct risk assessment and examinations' visits to the registered audit firms, particularly those who are auditing the financial statements of the listed companies. This can be done mutually in cooperation with the MOE, as the latter is the regulatory body responsible for licensing and supervising audit firms as per the federal law. However, the main objective of these visits is to ensure that these firms have the required level of internal controls and professional competencies to conduct the audits on the listed companies as per the SCA rules and regulations that govern the capital markets, especially corporate governance codes and international financial reporting standards.

The financial crisis also raised the importance of the compliance and risk management functions in the companies to ensure their long-term sustainability and business continuity. On the strategic level, the role of audit committees in the boards shall be enhanced and the members of those committees should be accountable seriously for the effectiveness of internal controls and accounting treatments which effects the financial statements of the company. This aims to force these committees to be more involved in the strategic decisions and act practically for the benefit of the company and its shareholders.

On the operational side, the functions of internal auditors or controllers also need to be empowered and developed to integrate with the role of compliance and risk management!The nature of internal audit functions requires a special expertise in the accounting field, in particular public accounting or forensic accounting. The SCA has to develop a special program that aims to govern this role in the listed companies through enforcing these companies to appoint fulltime internal auditors whom should be licensed and registered by the authority. Hence, the SCA can ensure the competencies and level of professionalism of internal auditors who are responsible specifically to look after the company's financials.

Although the SCA regulations require the companies to appoint an independent external auditor, the roles and responsibilities of those auditors shall be increased to ensure their ability to audit the financial statements fairly and deeply, this increase in role and responsibility will bring with it an increase of accountability, as those auditors will be questioned seriously about any failures.Functions of external auditors and their duties shall be covered in more details under the SCA rules and regulations. This aims to question those auditors in cases where there are any failures, and to specify a framework for those auditors to work within. The SCA shall have the right to demand listed companies to change their external auditors for every significant period – three or five years – in order to ensure the independency of those auditors and increase the level of credibility, within this period. The external auditor shall be asked to rotate the audit teams and individuals periodically.

Too big to fail companies which are known as "SIFI's" have great impact on the capital markets and their stabilities. The failure of any of such companies may result in the loss of confident in the whole market's system and the regulatory framework that governs it. Therefore, those firms need to fall under a special financial supervisory program that could be divided into the following:

1. Appointing two different external auditors to be responsible for auditing the financial statements of such a company,
2. Conduct a special risk assessment programs on these companies by the SCA to examine and audit their accounting records and financial statements,
3. Introduce a "Financial Information Intelligence System" that monitor the financials of these companies and predict any kind of false accounting through unusual financial results or indicators. This will allow the decision makers to take the appropriate decision in the right time to open any kind of investigation or predict any impacts of false accounting.

The current regime requires listed companies to present their financials within ninety days after the end of the fiscal year. This is quite long period and can be shortened in order to ensure the promptness of preparing and presenting the financials. This will reduce the opportunity of any intentions to false the accounts and focus on delivering the statements with the regulatory deadline. However, such deadline should be reduced in order to provide the companies with appropriate time to prepare their financials without any operational burdens.

Although the UAE Accountants and Auditors Association has been established in 1997. However, there is a critical need to have a federal organisation that has the legal power and financial resources necessary to conduct its mission in regard promoting the accounting and auditing profession in the UAE in cooperation with other regulatory bodies such as the MOE, the SCA, and CBUAE. Establishing such an entity will enforce its initiatives and promote the practices in the accounting field, form this entity, different initiatives can come to reality such as having a professional platform for accountants and auditors similar to the UK model. However and due to the vary in culture, this entity will be formed as a federal organisation instead of association.One of the recent initiatives that the UAE is issuing a new Law in December 2014 to that aims to strengthen the guidelines that are governing this activity and ensure the level of qualifications and competencies of auditors practicing this profession.[670]

Under the UK model, there is a clear legal sentencing and provisions for false accounting. Section 7 of the Theft Act 1986 considered a good reference as it states clearly the sanctions which could reach to seven years of custody, these sanctions are determined based on the amount of harm as stated in the Act. Such a model could be implemented for false accounting cases in the UAE to ensure minimising these cases as possible. Finally,

[670] Aaa4uae.ae (2014) *President of the United Arab Emirates issues a law on regulating the profession of auditors*. [Online] available from: http://aaa4uae.ae/wp-content/uploads/2014/12/Federal_Law_12_2014_organization_profession_auditors.pdf. [Accessed: 29 December 2014].

despite all what had been mentioned above, and the fact that the recent years has witnessed various initiatives and efforts to minimise false accounting's cases globally, regionally and locally, false accounting remained one of the biggest challenges that regulators still have to keep watching in order to ensure that it will not affect the markets and the investors.

## 7.6 Suggested Approaches to Problems Related to Corporate Governance

On 24 February 2010 the Organisation for Economic Cooperation and Development (OECD) published a report [671] that included a set of conclusions and best practice to complement its Principles and encourage enhanced corporate governance which relates to the following:

1. The need to improve the corporate governance framework - the OECD reports that the Steering Group's analysis showed a gap between existing standards and actual implementation. Although it is primarily the responsibility of companies, the board and shareholders to ensure compliance, jurisdictions should also regularly review their supervisory, regulatory and enforcement authorities to ensure effective implementation and timely update.
2. The governance of remuneration and incentives - remuneration is an issue for the board. The board must ensure that it aligns remuneration with the longer term interests of the company and this information should be disclosed in the remuneration report. The procedure for setting remuneration should be fully transparent and the roles and responsibilities of those involved should be clearly defined and separated. Remuneration policies and implementation measures should also be submitted to shareholders at the annual general meeting to raise awareness of the remuneration policy and enable shareholders to comment on the policy.
3. The governance of risk management - risk management is the responsibility of the board. An effective risk management policy should be implemented and it is good practice for those directors involved in setting such a policy to be independent of profits centres. Risk management and results of risk assessments should be disclosed "in a transparent and understandable fashion."
4. Improving board practices, including board composition, independence and competence - the OECD reports shows that the boards of many companies which it reviewed were dominated by the chief executive officer (CEO) which "stifled critical enquiry and challenge essential for objective, independent judgment." The chairman of the board

[671] The report was issued by the OECD Steering Group on corporate governance setting out conclusions and emerging good practices regarding corporate governance. It builds on the report entitled 'Corporate Governance Lessons from the Financial Crisis' and its subsequent, preliminary findings that were presented in 'Corporate Governance and the Financial Crisis: Key Findings and Main Messages'. See Oecd.org (2014) *Corporate Governance and the Financial Crisis Conclusions and emerging good practices to enhance implementation of the Principles*. 24 February 2010. [Online] available from: http://www.oecd.org/corporate/ca/corporategovernanceprinciples/44679170.pdf. [Accessed: 25 November 2014]; and Lexology.com (2014) *OECD: corporate governance and the financial crisis: Conclusions and emerging good practices to enhance implementation of the Principles*. February 26 2010. [Online] available from: http://www.lexology.com/library/detail.aspx?g=01930aa5-e406-4bcf-8426-376745bddb43. [Accessed: 25 November 2014].

should ensure that the board tackles the most important issues, and adequate measures should be put in place to ensure that the roles of the chairman and CEO are separated to avoid conflicts of interest. To promote board competence, the company should promote regular training evaluation and the results of that evaluation should be disclosed to shareholders.

5. The exercise of shareholder rights - the OECD has identified the need to improve the exercise of shareholder rights, especially by institutional investors.[672]

Corporate governance regulations/codes are one of the most effective apparatus that regulators use to achieve investor confidence in the boards and management teams of the companies they invest in. Sound corporate governance practices minimise conflict of interest, increase disclosure and transparency and greatly mitigate wrong managerial practices. As previously indicated, the UK regulatory framework for corporate governance comprises a number of sources including the Companies Act 2006, the Listing Rules (LR), Disclosure and Transparency Rules (DTR)[673] and finally the UK Corporate Governance Code (the Code).[674]

The Code issued by the Financial Reporting Council (FRC) is a set of non-mandatory principles that listed entities are required to adhere to. Disclosures on corporate governance in annual accounts and reports of listed companies, under what is now referred to as the "Combined Code," were originally prompted in 1992 by the recommendations of the Committee on the Financial Aspects of Corporate Governance (the Cadbury Committee). Responsibility for updating the corporate governance requirements and associated guidance on internal controls now rests with the FRC. The FRC also has stringent corporate governance requirements especially with regard to matters related to financial reporting and accounting. These requirements, however, are part of an overall EU directive and apply to all member states and not just the UK's financial regulatory authority.

Listed companies are required under the Listing Rules either to comply with the provisions of the Code or explain to investors in their next annual report the reasons for not having done so. In the event that shareholders are not satisfied they can use their powers, including the power to appoint and remove directors, and to hold the company to account. This type of "leadership by consensus" as it were has its merits. It ensures that senior management remain accountable to their shareholders and is a constant reminder to them that the management of the business to which they have been appointed is a position of trust that cannot be abused. In a sense, the format is similar to that of a democratically elected parliament. The elected leaders serve the people, in this case the shareholders and not the other way around.

In the FCA's Conduct of Business (COB) strict corporate governance measures ensure that a firm must act honestly, fairly and professionally in accordance with the best

[672] *Ibids*.
[673] The FCA Disclosure Rules and Transparency Rules, *supra* note 329.
[674] The UK Corporate Governance Code, *supra* note 488.

interests of its client (referred to as the "client's best interest rule").[675] In order to comply with the clients best interests rule a firm must always seek the best interests of its client at all times as well as provide appropriate information in a comprehensible form to a client about the firm and its services so that the client is reasonably able to understand the nature and risks of the service and consequently, to take investment decisions on an informed basis.

There are also strict rules on inducements and gifts and firms must not pay or accept any fee or commission or provide or receive any non-monetary benefit other than a fee, commission or non-monetary benefit paid or provided to or by the client or a person on behalf of the client. The guidance on inducements [676] ensures that the firm always acts honestly, fairly and professionally in accordance with the best interests of its clients. Another key issue related to good corporate governance is to ensure record keeping is always updated. A firm must make a record of the information disclosed to the client in accordance with COBS 2.3.1R [677] and must keep that record for at least five years from the date on which it was given.

Therefore, the UK's approach towards dealing with corporate governance is to provide a framework (the Code) for firms. The fact that this is voluntary, in the researcher's opinion, adds the onus of responsibility on the board of directors and management to ensure that a system is put in place since every year each company is obligated to report to its shareholders whether its board and senior management have abided by the rules. Ultimately, the shareholders are empowered by law to remove a board member who has not conducted himself in a suitable manner. In essence, CGRs are about ensuring that the board of directors and senior management conduct themselves in suitable and appropriate manner. Good corporate governance code, like the one used in the UK, are based on transparency and accountability.

It is difficult to measure good corporate governance and it is certainly more difficult to oversee, since the conduct of the board of directors and senior management of a firm is essentially a closed affair between the board and its company. Assessing whether companies do in fact comply can be a rather subjective call. [678] That is why, each firm with a premium listing on the LSE must state whether its board has been in compliance with FRC code or not. The shareholders, at the annual meeting are then permitted to vote on the suitability of a board member or for his removal. Thus, at the risk of being removed from the board members are likely to ensure compliance with this Code.[679]

The UK and other countries in the EU and around the world have as a central plank of their corporate governance regime a voluntary code that has the principle of comply or

[675] Fca.org.uk (2014) *COBS 2.1 Acting honestly, fairly and professionally*. [Online] available from: https://fshandbook.info/FS/html/handbook/COBS/2/1. [Accessed: 18 December 2014].
[676] Fca.org.uk (2014) *COBS 4.2 Fair, clear and not misleading communications*. [Online] available from: https://fshandbook.info/FS/html/handbook/COBS/4/2. [Accessed: 18 December 2014].
[677] Fca.org.uk (2014) *COBS 2.3 Inducements*. [Online] available from: https://fshandbook.info/FS/html/handbook/COBS/2/3. [Accessed: 18 December 2014].
[678] Keay (2014) *'Comply or explain…', supra* note 143.
[679] *Ibid*., 295.

explain at its core. Experience demonstrates that countries that have implemented comply or explain, enjoyed a convergence towards better governance practices. The perception of comply or explain in the UK is very positive, however; while accepting the fact that the principle is considered by many participants and regulators as an appropriate and efficient regulatory mechanism, it has been found by others that the approach operates with deficient principle; such deficiency can hinder the emergence of better corporate governance practices.[680]

The first deficiency is apparent form the lack of shareholder engagement. This is a matter of significant concern, as the principle is predicated on the basis that the shareholders will be the ones who will monitor board compliance with code provisions; and that if they do not comply, shareholders are to ensure that the board provides adequate explanations for deviating. Secondly, statements by companies that are designed to explain why the company has not complied are often very brief and uninformative.[681]

The comply or explain concept would work better if regulators or other authorities had the power to check that companies had in fact complied with code provisions when they did not provide explanations for non-compliance, and to evaluate explanations – when provided- for deviating from the code.[682] Such a move would mean that appropriate sanctions have to be introduced for board failures. These could include, first, the regulator conveying to the company's board informally that the principle has not been adhered to, together with the threat of further action if the company does not rectify its failings. A second and stronger possible sanction is for the regulator to publish any breaches of the comply or explain principle. This could be seen as a public censure of companies who fail to comply. Critically, any decision to provide for statutory regulation in the area under consideration, has to be thought thoroughly so that the gains made under comply or explain are not lost.[683]

In KSA, one of the key recommendations of the IMF towards improving corporate governance involves IOSCO principles relating to KSA issuers specifically with reference to clarification of the role of the CMA in assessing the duties of directors of listed companies. This would need to have amendments to both the CMA and the MOCI legislations. Nevertheless, an awareness of the importance of good corporate governance is beginning to emerge in KSA.[684] In the wake of the market correction of 2006, authorities and market regulators pushed for better corporate governance and legal and institutional reforms. These included the CGRs of 2006 for listed companies,[685] guidelines on corporate governance best

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[680] RiskMetrics Group (2009) *Study on Monitoring and Enforcement Practices in Corporate Governance in the Member States*. 23 September 2009. [Online] available from: http://ec.europa.eu/internal_market/company/docs/ecgforum/studies/comply-or-explain-090923_en.pdf. [Accessed: 2 December 2014].
[681] MacNeil & Li (2006) "*Comply or explain": Market discipline*…', *supra* note 492.
[682] Ec.europa.eu (2011) *Green Paper on the EU corporate governance framework*. [Online] available from: http://ec.europa.eu/internal_market/consultations/2011/corporate-governance-framework_en.htm. [Accessed: 22 December 2014].
[683] Keay (2014) *'Comply or explain*…', *supra* note 143.
[684] For further details on the numbers of the CMA workshops for companies listed on Tadawul over the years of 2009-2013, see Cma.org.sa (2012) *CMA Annual Report 2012*. [Online] available from: http://www.cma.org.sa/en/Publicationsreports/Pages/AnnualReport.aspx. [Accessed: 3 May 2013].
[685] The CMA Corporate Governance Regulations, *supra* note 231.

practices for banks and further strengthening of the supervisory functions across the financial sector. A definitive change has already been seen in the CMA in the publishing of its transparent and revealing financial report for 2012.[686]

As of January 2011, listed companies were required to comply with Article 15 of the CGRs by forming a nomination and remuneration committee by the Board of Directors.[687] This committee is tasked with the review and audit of the rules and policies related to appointment, qualifications, structure, authorities, independence, and remuneration of the board members. The composition rules of the nomination and remuneration committee are proposed by the board of directors and approved by shareholders in a general assembly. These changes were brought about in order to develop accountability in KSA equity capital markets.

Companies licensed by the CMA to conduct capital-market activities are also required to comply with corporate governance rules pursuant to circulars issued by the CMA. Effective January 2012, the CMA-licensed entities are required to include independent members on their board of directors and to disclose in annual reports information about board composition, activities, internal audit and financial matters. Further, CMA-licensed entities must establish corporate governance policies to cover different areas including board membership appointment criteria; authorities of the board members; ethics rules for employees and composition of audit and remuneration committees. Violators have been penalised by the CMA up to SR 50,000.[688] Also as part of the CMA's strategy of gradual mandatory implementation of the Corporate Governance Regulations, the Board of the CMA issued many resolutions to make certain articles and paragraphs of the Regulations mandatory for companies listed on Tadawul.[689]

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[686] The CMA Annual Report 2012, *supra* note 684.

[687] The CMA Corporate Governance Regulations, *supra* note 231.

[688] Cma.org.sa (2014) *Application of Penalty by CMA*. 14 October 2012. [Online] available from: http://cma.org.sa/En/News/Pages/CMA_N_1221.aspx. [Accessed: 18 December 2014].

[689] The Board of the Capital Market Authority issued many resolutions making the following articles and paragraphs from the Corporate Governance Regulations mandatory:

a. Resolution No. (3-40-2012) dated 17/2/1434H corresponding to 30/12/2012 in relation to paragraphs (i) and (j) of Article 5 effective from 1/1/2013.

b. Resolution No. (1-36-2008) dated 12/11/1429H corresponding to 10/11/2008 making Article 9 of the Corporate Governance Regulations mandatory on all companies listed on the Exchange effective from the first board report issued by the company following the date of the above resolution.

c. Resolution No. (1-33-2011) dated 3/12/1432H corresponding to 30/10/2011 in relation to paragraph (b) of Article 10.

d. Resolution No. (3-40-2012) dated 17/2/1434H corresponding to 30/12/2012 making paragraphs (c) and (d) of Article 10 of the Corporate Governance Regulations mandatory from 30/6/2013.

e. Resolution No. (1-36-2008) dated 12/11/1429H corresponding to 10/11/2008 making paragraphs (c) and (e) of Article 12 mandatory from year 2009.

f. Resolution No. (3-40-2012) dated 17/2/1434H corresponding to 30/12/2012 in relation to paragraph (g) of Article 12 from 1/1/2013.

g. Resolution No. (1-36-2008) dated 12/11/1429H corresponding to 10/11/2008 in relation to Article 14 from year 2009.

h. Resolution No. (1-10-2010) dated 30/3/1431H corresponding to 16/3/2010 making Article 15 mandatory on all listed companies effective from 1/1/2011.

For more details, see the CMA Annual Reports, *supra* note 206; and the CMA Corporate Governance Regulations, *supra* note 231.

On another note, KSA's compliance with the OECD Principles of Corporate Governance[690] indicate that although basic shareholder rights appear to be in place, all shareholder have a clear and equal right to participate and vote in general meetings. Cumulative voting has also been recently introduced as per the corporate governance rules as a method of nominating members of the board of directors. However, the corporate governance regulations governing the disclosure of third party transactions are still underdeveloped.[691] There is a lack of reference to the issue of third party transactions in the actual CGRs. This will need to be addressed if KSA is to resolve its issues of investor confidence.

As we have seen from the previous chapter in relation to the data released in the CMA 2012 annual report, there appears to be a significant amount of malfeasance and manipulation in the markets. Many investors, including potential international investors have voiced concerns that brokers and other market participants engage in improper conduct and market abuse. This includes trading on inside information, improper trading of shares in investor accounts and market manipulation. Another constantly stated problem with CGRs in KSA is the wide held belief that compliance with non-financial disclosure requirements is weak including board of directors corporate objectives, beneficial ownership, qualification and nominations.[692]

In a similar vein, KSA and the UAE have both adopted detailed corporate governance rules in the hope of mitigating and reducing problems related to poor corporate governance. The CMA's CGRs framework covers the protection of the rights of shareholders, disclosure and transparency as well as board structure and responsibilities. The implementation of KSA's CG code was initiated in 2006 as a result of the market correction and came at a most opportune time indeed. The problems associated with remuneration and nomination of board members was solved by ensuring, as per the CGRs, that a nomination and remuneration committee was formed and that this was composed of board members. As of January 2012, all CMA licensed entities are required to disclose in their annual reports details relating to board of directors, compensation as well as independence of board members.

Furthermore, recognising the importance of applying the standards and rules of governance on the CMA's business and internal operating environment in order to strengthen its internal organisational and regulatory structures in line with best practices and standards adopted in similar international authorities to be a role model followed by related parties, the CMA Board approved the establishment and formation of a number of ad-hoc committees, and approved the regulations and rules governing these committees. Under the bylaws of the Internal Audit Committee and the rules governing the business of ad-hoc committees, the CMA Board approved the establishment and formation of the Internal Audit Committee and Ad-hoc Committees such as Committee for Capital Market Institutions Supervision and

[690] First released in May 1999 and revised in 2004, the OECD Principles are one of the 12 key standards for international financial stability of the Financial Stability Board and form the basis for the corporate governance component of the Report on the Observance of Standards and Codes of the World Bank Group. See the OECD Principles of Corporate Governance, *supra* note 489.

[691] Worldbank.org (2009) *'Saudi Arabia: Corporate Governance Country Assessment*…,' *supra* note 345.

[692] *Ibid*., at 3-4.

Corporate Finance and Issuance; Committee for Market Supervision and Enforcement; and the Executive Committee.[693]

The CMA has also built an Electronic Communication System that enables listed companies to update their data, fill in and submit the forms required by the CMA electronically. With this system, the CMA can also send circulars to listed companies electronically. The system is intended to apply the concept of e-government and standardised means of communication in addition to accelerating transactions between the CMA and listed companies. The number of forms that have been reviewed through the system since it went live on 1/1/2013 stood at 6,348 forms up to 31/12/2013. During 2013, the following forms were reviewed:

- Designating representatives of listed companies.
- Submitting financial statements of listed companies.
- Résumés of nominees to board membership of companies listed on the Saudi Stock Exchange "Tadawul."
- Information of members of boards of directors, senior executives and their relatives.
- Reporting expired membership of a board member, or termination of business relations with a senior executive
- Compliance with the Corporate Governance Regulation.[694]

In the UAE, corporate governance has been regulated for a number of years by the SCA via the old CGRs No. R/32 of 2007. In October 2009, the MOE issued a new CG resolution which amended the old and was referred to as the Governance Rules and Corporate Discipline Standards (the 2009 Resolution).[695] This code refines and updates the old especially taking into account international standards. It is mandatory on all listed companies (except foreign listed companies) and there is no voluntary opt-out. The key issues in the new code covered many areas which the older one had not. The new code addressed many problematic scenarios which the Authorities were forced to deal with. Key issues addressed included the following matters:

- Board Structure – balance of executives, non-executive and independent directors.
- Separation of the role of Chairman from that of CEO.
- Directors duties and responsibilities.
- Board Committees including the appointment of an audit committee and nomination and remuneration committee.
- Internal control – including the appointment of a compliance officer.
- Governance reporting – annual compliance reports to shareholders and the SCA too.

The UAE has also taken major steps to alleviate corporate governance problems by amending the CGRs again in 2014. The new regulation also sets out the key issues including related parties transactions as well as financial disclosure requirements. The SCA is

[693] The CMA 2013 annual report, *supra* note 607, at 35.
[694] *Ibid*.
[695] The SCA Resolution of 2009 Concerning Governance Rules, *supra* note 295.

continuously developing the corporate governance code and streamlining it with the IOSCO principles. It has also developed the code to conform to the relative international competitiveness indicators including but not limited to the investor protection indicator in the World Bank doing business report,[696] and the board of director's effectiveness indicator at the world competitiveness yearbook issued by the International Institute for Management Development (IMD).[697] The SCA's efforts were rewarded by achieving the number one rank in MENA region,[698] as well as achieving the number one rank in corporate board effectiveness (Corporate boards do supervise the management of companies effectively).[699]

To be able to achieve that, the SCA made the following specific changes to CGRs in order to enhance investor protection.[700] It extended the definition of related party to include persons that assume any of the following positions or their relatives, including board chair and members, the executives in the company, its subsidiaries, its parent, sister company or executives in any company with a controlling stake. It clearly defined the meaning of conflicts of interest and introduced provisions to regulate conflicts of interest. It also determined responsibility for any harm, whether to the company or to a shareholder, caused by a transaction with a related party or if such transaction is unfair or entails a conflict of interest. In addition, it indicated the shareholders with 5% ownership right to review all related party transactions documents either personally or through an independent auditor hired by them from the company, the regulator or through a court order. Not only the court can rule the transaction null and void it can ask the related party for compensation and to return any profits generated if the court finds that its harmful to the company or any of its shareholders.

It also required the chair of the board to provide the SCA with the information of related party transaction along with a statement ensuring and documenting the fairness of the transaction and that it benefits the company and its shareholders. If the value related party transaction is equivalent to 10% or more of the company's total assets (as valued in the latest annual or quarterly reports), then the related party has to disclose such transaction, its nature and the benefits gained from it to the board. The board has to disclose such information and any conflicts of interest to the exchange, in its financial reports, and must present it in the general assembly meetings. If the related party failed to meet the above disclosure requirements, then the board or any shareholder with a holding of 5% or more of the company's shares has the right to file a suit with the relevant court against the related party to

[696] Doingbusiness.org (2014) *Doing Business 2015 Going Beyond Efficiency*. 29 October 2014. [Online] available from: http://www.doingbusiness.org/reports/global-reports/doing-business-2015. [Accessed: 2 December 2014].

[697] Imd.org (2014) *IMD World Competitiveness Yearbook 2014 Results*. [Online] available from: http://www.imd.org/wcc/news-wcy-ranking/. [Accessed: 2 December 2014].

[698] Imd.org (2014) *IMD World Competitiveness Ranking 2014*. [Online] available from: http://www.imd.org /uupload/IMD.WebSite/wcc/WCYResults/1/scoreboard_2014.pdf. [Accessed: 2 December 2014].

[699] Doingbusiness.org (2014) *Ease of Doing Business in United Arab Emirates*. [Online] available from: http://www.doingbusiness.org/data/exploreeconomies/united-arab-emirates. [Accessed: 2 December 2014].

[700] The above amendments were introduced by the Ministerial Resolution No. (250) of 2014 and were parts of the Ministerial Resolution Provisions No. (518) of 2009 Concerning Corporate Governance Rules. See *supra* notes 295, 566.

terminate the transaction and ask to return to the company any profit or benefit generated from the transaction.[701]

There are other suggested amendments to the UAE CGRs such as the requirement to have some relevant experience with some of the Nomination and Remuneration Committee members to help accomplish its required tasks, and if this is not possible, then the Committee can use experts to help it to accomplish its tasks. Also, the code should address the rule of having a sufficient number of non-executive members to form a Nominations Committee, and not permitting the board of directors to use external members in that committee, although it is justified for the Audit Committee. There is also a need for the legislation to reconsider granting the chairman of the board of directors a casting vote. The legislation can keep the casting vote of the chairman at board meetings when members' votes are equally divided, provided that the chairman has been chosen through the general assembly of the company. In other cases, it should postpone the vote on that matter to a later meeting where the number of the present members can change, and the required majority for the decision can be achieved or refer to the general assembly of the company in cases of an equality of votes.Also the CGRs do not require that the financial expert member of the Audit Committee to be a non-executive member or to be independent whereas it should be required in order to be a part of the said committee.[702]

## 7.7 Conclusion

In light of the discussions in this chapter, it can be safely concluded that the key themes underlying the endemic problems of the securities markets have been addressed to a large extent by the developed markets like the UK. In the meantime, the markets of KSA and the UAE are in the process of identifying and addressing increasing transparency, strengthening the disclosure regime, stricter enforcement, containing insider dealing and better investor education. The disclosure and transparency can be strengthened by ensuring timely and adequate disclosure, both pre-trade and post-trade as well as creating conducive environment for participation by long term foreign investors. The enforcement of laws and regulations has to be balanced, consistent and equitable, without fear and favour and the 'naming and shaming' of perpetrators of financial misconduct should be encouraged.

The difficulty to prove market malpractice of insider dealing is better contained by enhancing the legal framework to precisely define and criminalise the malpractice. Further measures include increasing the penalties and including disgorgement of illegal gains while at the same time developing the legal infrastructure. This can be further enhanced by imparting financial knowledge to legal practitioners and having an appropriate appeal system in place. Putting all these elements together will have the dual impact of discouraging the practice of insider dealing as well as providing redressal in case of occurred instances.

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[701] *Ibid*.
[702] Abdel Moniem (2014) '*Corporate Governance in the UAE Legislation*', *supra* note 297.

The principle of 'regulation by objective' implemented through the twin peaks model has to be encouraged to deal with the systemic risks, clearly delineating the roles of the prudential supervision and the conduct of business requirements while the market volatility can be tackled by means of reducing the herd mentality of investors by empowering them with sound financial education as well as encouraging the participation of foreign investors with longer term outlook for the markets. Mandating better information dissemination can also be a potential and powerful tool in the hands of the regulators which will lead the investors to better deal with episodic market volatility. Whereas, in matters of implementing sound corporate governance, substantial progress has been done in the UAE as compared to KSA markets, further steps in regard to implementation and enforcement of the CG Codes will lead to better corporate governance at the listed companies thereby leading ultimately to fairer and more efficient markets and enhanced price discovery. The final chapter of this thesis will use the above mentioned findings and analyses to formulate the conclusions and to suggest the reforms to deal with the six main themes of this thesis.

# Chapter Eight

# Conclusion and Recommendations

## 8.1 The Outlook for the Future –Ever– Increasing Globalisation within the Securities Markets of the World.

To begin to understand the effect of globalisation on equity capital markets around the world we need to first define the term 'globalisation' within this context. The world is increasingly connected and the Internet as well the increase of specialist technology platforms have resulted in people and businesses far removed from one another to be easily connected at the click of a button. There are simply no more boundaries. Globalisation may therefore be termed as the process of international integration as a result of the almost simultaneous exchange of information, ideas and culture. Markets all over the world are required to constantly update, review and re-interpret their activities and platforms in light of changes that are occurring. It seems that in order to be considered as an attractive market within which to invest, stock exchanges as well as financial regulators must adapt the advent of technology as well as regulations must be constantly upgraded.

The impact of globalisation has affected capital markets around the world. Deregulation of the markets as well as relaxing (or at least trying to in the case of KSA) restrictions on the acquisition of domestic securities by foreign investors are two key initiatives that have been a result of globalisation. We may also include in this the relaxation of rules that allow foreign entities to issue bonds. All the major financial centers of the world today are heavily populated by foreign banks and investment houses that are fully involved in underwriting bonds and stocks in domestic stock markets. Technology and money are now highly mobile. Brokers and dealers are inter-connected on a massive scale providing investors with real time prices and the ability to monitor large geographically diverse investment portfolios on-screen in complete details. The ability to instantly monitor market performance has totally changed the risk/return strategy of financial institutions. Decisions which had previously taken a few hours or days to be made are now made almost instantaneously by computer and algorithmic trading programs.

Cross border listing that allow companies to raise capital anywhere in the world has flourished as evidenced by the LSE increased role in such activity especially on the alternative investment platforms such as AIM. More and more companies worldwide are tapping foreign markets to raise funds. For example, AIM has assisted well over 3,100 companies raise in excess of US$ 150 billion in the last decade and it is the home to 1,253 companies from diverse geographic locations that have a total market capitalisation of almost UK£65 billion of which 20% are foreign entities.[703] By the provision of balanced regulation, international investor base, geographical reach and sector growth as well as a huge expert

[703] The LSE AIM, *supra* note 26.

advisory network, AIM is today one of the world's primary destinations for serious long term investors.

The effects of globalisation have produced visibility and a high profile for companies in the UK that could not have taken place within a closed and non-connected environment. The practice of cross listing is the most significant phenomenon that creates linkages among stock exchanges. The number of dual listed firms has increased significantly during the last decade. Many leading corporations' shares are traded more in foreign stock exchanges than traded in their home exchanges. The majority of foreign firms listed on second stock exchange have to meet dual requirements; other firms that may not meet the second exchange's requirements use the so-called depository receipts as an alternative for cross listing.

Today's globalised world is dominated by large financial institutions such as pension funds, mutual funds, insurance companies as well as large "too big to fail" banks that realised tremendous losses due to the 2008-2012 financial crisis. The issue of size is moot.[704] Large banking and insurance groups still dominate the financial services markets. Such large groups are a hallmark of today's globalisation and though heavily criticised for their size as being too large have nevertheless emerged stronger within the global markets. Similarly, the traditional role of the stock exchange has changed.

As a result of the sweeping and constantly changing effects of technology, an explosion of internet and computer based trading systems has changed our perception of stock markets. Anyone, anywhere can trade from home today. Stock exchanges are completely accessible from anywhere in the world. Accordingly, stock markets have to change to meet these needs. Additionally, there are a number of new factors that continue to affect the operation of the stock exchanges. Listing rules have been harmonised on major global exchanges and information disclosure requirements are generally similar on the major stock markets. The way companies present their annual and quarterly statements is moving towards a set of harmonised international standards. Some multinational enterprises are raising new capital on several stock markets simultaneously. This requires coordination between exchanges. It is increasingly being realised that the home country of a company which has shareholders around the world has a responsibility for ensuring that price-sensitive and material information is available to all shareholders and not just to those in the home country.

Thus international regulatory initiatives, particularly those aimed at standardising accounting and other disclosure requirements need to be enforced vigorously. The combination of institutionalisation, automation and globalisation will lead to more market liquidity, greater volatility and lower trading costs. It would therefore appear that the world's stock markets are heading rapidly toward globalisation through two major changes namely, the liberalisation of international stock trading rules, and the globalisation of stock trading practices.

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[704] Campbell & Lastra (2010) *'Revisiting the Lender of Last Resort…', supra* note 389.

## 8.2 Disclosure & Transparency

This thesis has sought to provide a detailed comparative overture of capital market regulations in the UAE, KSA and the UK. The thesis has researched several key themes in each of these markets in an attempt to pinpoint the key regulatory frameworks that are either lacking or under-represented with specific relevance to the UAE and KSA.

London is held as the best practice example for several reasons including the fact that GCC nations have historically and traditionally had very close business ties over the last fifty years. Furthermore, the London capital markets have always been considered a safe haven for GCC funds and as a result, many rules and regulations have been adopted in the hope of emulating the UK's success in becoming a global financial hub. Of primary importance to this research are the key differences between the UAE and KSA on one hand and the UK on the other with regard to disclosure and transparency. International investors hold London's disclosure and transparency regime in very high regard. Market participants trust the system.

Companies listed on the UK exchanges cannot circumvent disclosure rules with impunity since the repercussions from both a financial as well as reputational perspective would be enormous. The research demonstrates that disclosure and transparency issues need to be seriously addressed in both the UAE and KSA in order for them to be on par with London. Cultural matters must be taken into consideration as well since it is pointless to impose written rules and regulations that have no basis in current cultural operating norms. Successful investor protection requires strong laws and equally strong enforcement. Investor protection in securities markets relies on having an effective regulator that is not only empowered but is seen to use such powers in an effective manner.

It is only by taking action that a regulators reputation is cemented. Indeed, it can be surmised that there is no point in empowering a financial regulator on paper if the regulator does not take strong actionable steps when required. The research has concluded that this may be construed as cultural idiosyncrasies which, nevertheless, do negatively impact investor perception.

There is no doubt that the UK's financial regulators take quick prescient action in the event that rules are breached. No-one is above the law there. Can the same be said about the UAE and KSA Capital markets? It is evident from the thesis research that tremendous steps have been taken by GCC regulators to improve the financial milieu and certainly, in the case of the CMA, instances of disclosure by the CMA of wrong doing have increased tremendously.

It is precisely this type of disclosure which lends confidence to international investors. Market participants and investors need to know that they will be treated in the same equitable manner as everyone else and that no preference will be given simply because the violating party is a locally based entity or for that matter, well-connected. It is therefore imperative that the power of the regulator to enforce securities laws (and thus enhance transparency) is generally conceived of as comprising investigation of any breaches as well as the taking of appropriate action including swift (but just) punishment. Proponents argue that transparency makes capital markets accessible to both retail and institutional clients, enhances market integrity and stability, and provides regulators greater ability to monitor activity. They reason that with the introduction of transparency, price discovery and the bargaining power of previously uninformed participants improves.

The research would indicate that the UAE market is equally transparent to that of KSA especially in regards to the price discovery perspective. Price discovery is essential for an investor to assess viability of markets returns. Such timely price disclosure builds credibility. A transparent market also disseminates timely post-trade information. In today's fast paced and interconnected world it would seem very strange indeed if investors were unable to access corporate price and trading information of any given listed stock but instead had to rely on a limited set of options including telephone calls with broker dealers or consultations with other third party specialist who would provide such information for a fee.

CMA and the SCA have, over the years spent considerable time and effort in updating their price reporting platforms thus benefiting local investors as well as attracting international investors in the process. Similarly, in the UK and as per both MIFID and the FCA regulation, all EU regulated market securities (including all the UK securities) are supported by a pan-European trade reporting service.[705]

Such price dissemination is crucial in order to maximise investor confidence and on a stock exchange as prestigious as London, it is imperative that investors have no doubt in their minds that corporate and financial information will be released in a timely and efficient manner. Furthermore, the content of this information must be detailed and pertinent and investors need to be certain that the Authorities (in this case the FCA and the UKLA) have vetted all the said information to ascertain its veracity. As a result, investors have high confidence in the UK's financial Authorities as well as the LSE. The research finds that in the UK, the most successful medium for improving market transparency are the open forums held by the FCA in which market participants are free to openly discuss (and criticise) rules and regulations with the regulator in order to iron out any differences they may have. This manner of open debate has proved to be most conducive. The thesis finds that such a manner of open policy building is lacking in the GCC, particularly KSA and that such an approach would be invaluable towards boosting investor confidence.

## 8.3 Breach of Disclosure & Enforcement

The research finds that swift punishment and enforcement in the GCC capital markets vis-à-vis London is somewhat lacking. Why is this the case? Is this a reflection of poor enforcement? Are disclosure regulations insufficient? Or are regulators politically unable to take action? This matter naturally leads to issues of 'independence' of the regulator. Enforcement of the disclosure regime in KSA is derived from the fact that judicial enforcement is construed as weak.

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[705] LSE Trading Services, *supra* notes 520, 521.

When judicial enforcement is inadequate in protecting investors then it is the function of the regulator to step in and provide such protection. The research concludes that the CMA is definitely attempting to do this although historically this has been the Achilles heel of the CMA for many years. Strong enforcement is essential to maintain and improve the capital market and consequently, the role of both the CMA and the SCA is significant in terms of investor protection and market growth. Government laws and regulations ensure transparency and disclosure requirements are diligently followed through. In the UK, the Authorities are not at all shy in imposing penalties on those who do not abide by the rules.

Although there have been fines imposed on some listed companies for breach of disclosure regime and on participants for insider dealing in the UAE stock market. Though it would nevertheless appear in this research that payment for violations appears to be far less than say the UK regulator. It is clear that many companies in both KSA and the UAE do not have sufficient fines levied against them. This may be due to plethora of reasons including reluctance of the financial regulator to take action due to political considerations.In contrast to this, is the ability of the UK regulators to sanction breaches of the disclosure and transparency rules involves potentially indefinite amounts of fines including both monetary as well as fines and bans imposed upon the violator.

The research also shows that a plethora of regulations have been passed including investment fund regulations, market code of conduct as well corporate governance which have indeed provided a clearer framework for companies and individuals to use.[706] However, it is the application of these rules that has given cause for concern. There is no point in having detailed regulations if there is no one to enforce these rules. In one of its regular assessments of the KSA capital markets, the IMF [707] has commented that the CMA does not enforce penalties on board members of KSA listed entities who do not adhere to corporate governance regulations. This is a poor precedence to follow and sets a very bad example for other perpetrators. It means that the rules can be broken with impunity. Disclosure and transparency in enforcement also appear to be an issue. Enforcement penalties are not exercised equally across all the listed entities on Tadawul with the result that the CMA has been unable to demonstrate a balanced, consistent and equitable track record in its regulatory action.[708] Thus, as Tadawul is significantly larger than other GCC markets, it is expected that it carries the same reputational weight amongst international investors.

Having researched the rules and regulations in both KSA and the UAE, the thesis finds that any perceived or actual lack of prevention of violations may be related to the financial authority's lack of intervention. Regulators in KSA and the UAE do not appear to move as swiftly nor take the necessary preventative measures as the UK's. This harms investors' confidence since the violators go unpunished. When this happens any international investors waiting on the side lines may have second thoughts as to participation in the market with the obvious subsequent loss of foreign direct investment. Both the CMA and the SCA need to be seen by international investors to tackle breaches with impunity and a firm hand.

[706] CMA Implementing Regulations, *supra* note 202.
[707] Worldbank.org (2009) '*Saudi Arabia: Corporate Governance Country Assessment*…,' *supra* note 345.
[708] *Ibid*.

The reasons behind this lack of uniformity in exercising regulatory power must be addressed. Is this lack of uniformity a function of the regulators' inability to execute swift action? Or is it because the regulators simply are not aware of the violations? Or is it much more of a case of allowing the perpetrators a wide degree of leniency due to other political considerations? The research has concluded that both the CMA has wide and sweeping powers as per laws issued and it is therefore unlikely that an assessment of inaction can be boiled down to poor regulatory empowerment. The wide and strong powers of the CMA for example provide it with the ability to severely sanction offenders. However, a great hindrance to the proper enforcement of the disclosure rules and to the prevention of insider dealing is the weak penalties that are available in the SCA Law in the case of breach of related rules. In other words, if the punishment is not severe enough, it will not become a deterrence to companies and individuals who are most likely to commit such breaches.

## 8.4 Investor confidence

The research has also concluded that although both the UAE and KSA capital markets have made marked improvements over the years in attracting investors, there still remains much improvement on attracting and retaining international investors specifically foreign investors. In KSA, the complete lack of a foreign investor's ability to 'directly' enter the market is prohibitive and clumsy (although as stated in this thesis, the CMA has recently taken steps to amend by introducing regulations that correct this).

The UAE has taken a different approach and has, for all intents and purposes, practically opened up the markets to all investors wishing to directly participate. Although this is constricted in some stocks it is generally considered to be a far more investor friendly market than KSA.

The research has highlighted that lack of investor protection is considered major obstacle for the development of the securities market in the GCC especially KSA. Continuous effort is required by both the CMA and the SCA to attain the levels of market regulation benchmarked by the UK regulators. Potential weaknesses in legal provisos as well as enforcement machinery contribute to inadequate protection of investors which has a subsequent knock on effect on investor confidence. Both KSA and the UAE capital markets are pre-eminent in the Middle East. KSA's capital market is the largest in the region and the UAE's market is considered by many to be the financial hub of the entire MENA region and as such merits close attention.

Protection of investors inevitably leads to investor confidence and there are a variety of mechanisms available to build such confidence. For example, the SCA has, as of March 2014, attempted to further boost transparency and investor confidence by making it compulsory for all listed companies to establish a dedicated investor relations department.[709] Each listed entity will now need to appoint an individual who is tasked with communicating with investors and maintaining a good rapport with them. Furthermore, investors are to be

[709] The SCA decides to compel listed companies to set up investor relations department, *supra* note 567.

kept abreast of company news as well as kept updated with necessary financial and stock market information.Other significant attempts at improving transparency and disclosure include the issuance of new conflict of interest regulations in May 2013, the upgrade of investor protection and shareholder liability rules as well as a current detailed review and overhaul of related party transactions and their impact on transparency.

The research finds that the UK's track record in disclosure and transparency is second to none. All these requirements are diligently adhered to in the UK and the Authorities are not shy about imposing fines either. Perhaps one of the key lessons that the UAE and KSA need to learn from the UK is the extent of fines that the FCA and the PRA levy on violators. The FCA Fines Tables for 2014 [710] is a key reminder of just how often the FCA punishes transgressors. The fines levied for 2013 and published in March 2014 are a staggering UK£86 million. As mentioned before, rules mean nothing without strong policing.

The current disclosure and transparency rules with regard to all corporate governance issues, particularly with respect to disclosure of information related to beneficial ownership, board of director qualifications and nominations procedures still remain haphazard and unreliable.[711] However, Tadawul has attempted to correct this key concern by undertaking an initiative to publish ownership data online on a par with international best practices. Clearly, the CMA and Tadawul need to continue to develop the process to ensure that company disclosure is in compliance with applicable rules and it should also enforce disclosure of compliance equally across all offending entities without exception.

Disclosure frameworks have evolved relatively fast in the UAE. The IFRS are now a relevant reporting standard for listed companies in the UAE which are required by law to provide audited annual reports and semi-annual report too. Immediate disclosure of material events are also a compulsory requirement in the UAE and insider dealing has relatively become more regulated and controlled.

The 'naming and shaming' approach taken by the FCA's regime clearly has benefits towards improving transparency in the country. Ensuring that violators are named and shamed is certainly not an easy matter in KSA and the UAE where there is a deep cultural aversion towards airing faults and displaying violations in public and it is this cultural variation that leads to such disparity in investor perception. This must be changed.

The SCA had already issued detailed transparency and disclosure rules[712] as early as 2000 detailing the rules and regulations for ensuring capital market integrity as well as accuracy and efficacy of transactions. The transparency rules state that the SCA has the authority to cancel the listing of any security that violates regulations. Both stock markets in the UAE are required to submit to the SCA regular trading reports detailing volumes, stock movements and details on buyers so as to ensure compliance. On-going obligations (post-listing)[713] are similarly stringent and detail company requirements such as changes to

[710] For the FCA tables of fines, see *supra* note 529.
[711] Worldbank.org (2009) *'Saudi Arabia: Corporate Governance Country Assessment*…,'*supra* note 345, at 4.
[712] The SCA Regulations as to Disclosure and Transparency, *supra* note 275.
[713] *Ibid*., Article (36).

management and company structure, share movements and ownership, audited financials and interim reports. As mentioned, the SCA has attempted to further boost transparency and investor confidence by making it compulsory for all listed companies to establish a dedicated investor relations department.

## 8.5 Development of the secondary markets

The thesis has also researched key areas related to secondary market and issues relating to corporate governance. For the general investor, the secondary market provides an efficient platform for trading of securities. Needless to say, the primary and secondary markets in the UK are very well developed and have been for decades now. A well-developed secondary market includes several types of instruments such rights issues, issuance of bonus shares by listed companies to their shareholders, issuance of preference shares, government securities, corporate debt and debentures, bonds, GDRs and ETFs.

The secondary markets are as important to a booming financial economy as the primary are. However, this thesis has focused on secondary markets. The secondary market comprises of equity markets and the debt markets. In the UK, secondary markets include warrants, structured products, ETF's and OTC derivatives are also traded. Juxtaposed to the vast size that is the UK's bond market, to the practically non-existent secondary markets (for bonds and other structured products) in the UAE and KSA. How can such a vast difference exist? Surely the complete lack of secondary markets for bonds and other structured products in either the UAE or KSA would indicate weak primary market activity? An efficient secondary market is imperative for a fully developed financial market. The country suffers from a weak secondary market which is a reflection of a narrow investor base, a short-term investment culture and the absence of investment banks and large foreign institutional investors. Due to a lack of a liquid secondary market, portfolio and fund managers are also reluctant to invest.

The market also lacks fixed income institutional investors and investment funds that usually play an important role in secondary market trading. There does appear to be hope for change and the KSA authorities have suggested that one of the ways that they can begin to ameliorate disclosure and transparency issues is to allow foreign investors to actively and directly invest in KSA equity markets. Clearly, introduction of foreigners into the market will not directly improve transparency and disclosure but will certainly help persuade market participants that if foreign capital is to remain in the country then serious transparency and disclosure measures will have to be taken.

## 8.6 Improving Systemic Risk & the Introduction of the Twin Peaks Model

Like the UK, the severity of the threat to the UAE's systemic risk system prompted the UAE Authorities to consider a Twin Peaks approach to financial regulation, similar to that approach used by the Netherlands and Australia. Of the many calls for reform, one that was particularly important to the UK parliament was the reform and re-organisation of the regulation of securities markets as well as the shift from an integrated approach of financial regulation to that of a "Twin Peaks" system. The Act created a new regulatory framework for the supervision and management of the UK banking and financial services industry. The Act also separated and clarified between two key risks, namely, prudential and systemic.

The UK's shift, as it were, to a Twin Peaks regulatory system is, in effect, a deep reflection of the changes required by the Authorities and Parliament to avoid the threat of systemic risk. The UK's integrated "tripartite" regulatory approach, namely; the BOE, FSA and the Treasury were collectively responsible for the financial stability of the UK capital markets. Arguably, this system failed to effectively identify the issues that were building in the financial system as well as to take steps to mitigate these issues.

Of the many reasons, this failure occurred because the tripartite system vis-à-vis the Twin Peaks approach places responsibility for all financial regulation in the hands of a single financial regulator, in this case the FSA. The FSA was not able to effectively deal with all matters ranging from safety of the largest investment banks to the customer practices of the small financial advisers. Similarly, the BOE did not have the tools or levers to carry out its role effectively as primary provider financial stability whilst the UK Treasury has overall responsibility for maintaining the legal and institutional framework but empowered with no clear responsibility for dealing with a crisis which placed billions of Pounds of public funds at huge risk. The shift to Twin Peaks therefore necessitated a strong focus on two key areas, prudential regulation and conduct-of-business/consumer protection and markets regulation. There is now a dedicated focus on macro-prudential oversight to ensure that any future risks developing across the financial system are quickly identified and responded to. Overall, more coordination and cooperation within the regulatory bodies, should exist, be it single or twin.[714]

## 8.7 Tackling Insider Dealing

The research has also found that while the regulatory and legal framework in the UK has evolved over time and learned from past incidences in the markets. It has precisely defined the market malpractice of insider dealing, focusing on the defining who can be potential insiders, what type of undisclosed information can be price sensitive and in what manner it can be used in insider dealing. Thereafter, it developed an appropriate legal framework to manage the malpractice including linking the penalties to the proceeds of insider dealing, criminalising it and having an appropriate appellate court system for hearing of cases. Care has been taken in the UK's system to ensure innocent investors do not get penalised by putting the burden of proof to substantiate insider dealing on the prosecution.

[714] See Lui, A. (2012) Single or twin? The UK financial regulatory landscape after the financial crisis of 2007–2009. *Journal of Banking Regulation*. Volume 13. Issue 1. 34; and Campbell, A. (2008) The run on the Rock and its consequences. *Journal of Banking Regulation*. Volume 9. Issue 2.

In KSA and the UAE financial markets, the lack of investor knowledge and the prevalence of herd mentality coupled with the earlier system of making investments by 'word of mouth' recommendations entailed some amount of insider dealing. However, with the development of the markets, the regulators in both countries have put in place the legal infrastructure to manage such occurrences. The legal framework is lacking in terms of pinpointing the scope of insider dealing by appropriate definitions of price sensitive information and identifying insiders, however, the regulators have made substantial strides in enforcing the existing legal provisions around insider dealing. In the UAE, the amount of maximum penalties needs to be enhanced to act as a powerful deterrent and also to cover disgorgement of illegal gains. In KSA markets, the lawyers and officials in the appellate bodies, Tadawul, the CRSD and the ACRSD need to be provided with appropriate knowledge and appreciation of the insider dealing malpractice so that they are suitably qualified to understand the long term market impacts of such malpractices and can pronounce suitable corrective legal decisions.

### 8.8 Corporate Governance and Financial Reporting

Corporate governance is the system by which companies are directed and controlled. In its narrow sense, it is a source of shareholder value. Good corporate governance leads to better company performance, higher profitability and efficiency levels. In its wider sense, the definition takes into account all the company's stakeholders and corporate social responsibility. Corporate governance is important because it is part of the institutional infrastructure (laws, regulations, institutions and enforcement mechanisms) underlying sound economic performance. The UK's approach towards dealing with CG is to provide a framework for firms. The fact that this is voluntary, adds the burden of responsibility on the board of directors and management to ensure that a system is put in place since every year each company is obligated to report to its shareholders whether their board and senior managements have abided by the rules. Good CG codes, like the one used in the UK, are based on the principles of high transparency and strong accountability.

In a similar vein, KSA and the UAE have both adopted detailed corporate governance rules in the hope of mitigating and reducing problems related to poor corporate governance. The CMA's CG framework covers the protection of the rights of shareholders, disclosure and transparency as well as board structure and responsibilities. The implementation of KSA's CG code was initiated in 2006 as a result of the market correction and came at a most opportune time indeed. The problems associated with remuneration and nomination of board members was solved by ensuring, as per the CG Code, that a nomination and remuneration committee composed of board members was formed. As of January 2012, all CMA licensed entities are required to disclose in their annual reports details relating to board of directors, compensation as well as independence of board members.

Likewise, there has been a significant push in the UAE in recent years to further advance and promote the adoption of best corporate governance practice across many industry sectors. Listed companies have seen the introduction of compulsory requirements in the UAE, while financial institutions have been provided with non-binding guidelines as a starting point. In 2009, the SCA introduced a new corporate governance regulation which applies to all joint stock companies and institutions whose securities are listed on a market. All such companies were required to comply with the Corporate Governance Regulations that set high standards of corporate governance. There were various consecutive amendments to the Regulations that covered many areas and addressed many problematic scenario's which the Authorities were forced to deal with including board structure; separation of the role of Chairman from that of CEO; directors duties and responsibilities; board committees, conflict of interests, and governance reporting to shareholders and the SCA.

The CG regimes vary in regards to voluntary versus "comply or explain" or mandatory code where non-compliance is frowned upon and must be publicly explained and disclosed and breaches can result in penalties, whether these be financial or written or suspension from listing. Interestingly, a high level comparison between corporate governance regimes in the UAE, KSA, and the UK reveal some interesting differences. For example, in the UAE and KSA, it is required that at least one third of the board of directors be independent [715] whilst the corporate governance regulations of the UK, require that half of the board of directors be independent. Corporate governance compliance is mandatory in the UAE but is voluntary in the UK and to a certain limit in KSA.

Effective corporate governance is generally supposed to add or increase the value of a firm. This will of course be reflected in the stock price and in the buying pressure witnessed on a scrip throughout a trading day. With this in mind, the new UAE CG code should in fact increase investor confidence in the UAE and thus increase prices and boost market sentiment. With the progress of the corporate sector and financial market development in the UAE, the governance of firms has become and will continue to become an important issue for investors, foreign institutions and local corporations and is expected to play a central and important role in the further growth of the UAE equity capital markets.

Besides all the above, further development in the current regulatory regime is required through the criminalisation of all false accounting cases, and providing the regulators with the necessary legal authority to pursuit all related parties in such cases, including companies' auditors, too, and to take strict legal actions in these cases. In addition, the role of audit committee, the functions of internal auditors, and the responsibilities of the external auditors should be enhanced. Moreover, there is a need to develop a special financial supervisory regime for "too big to fail" companies not to mention to establish a professional legal body responsible for promoting the accounting and auditing profession especially in the UAE.

[715] See the SCA Resolution of 2009 Concerning Governance Rules, *supra* note 295; the CMA Corporate Governance Regulations, *supra* note 231; and the UK Corporate Governance Code, *supra* note 488 respectively.

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