

Protecting Individual Investors under Kuwaiti Securities Law

A comparative study

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

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Abstract

The financial market in Kuwait has existed for longer than the financial markets in the other Gulf countries. However, there has been limited regulation of stock exchange activities. This gap in the legislation was highlighted in the Suq al-Manakh crisis, when the absence of regulation resulted in heavy losses for large and small investors. This led the Government of Kuwait to enact a series of Acts from the late 1970s to 2010.

The securities market was built around this legislation, which helped to stimulate the economy by attracting investors. However, the practical application of these laws brought to light some shortcomings in the regulation of the stock exchange and specifically the need for the legal protection of investors against the risk of loss due to market abuse (manipulation and insider dealing) of securities, irresponsible actions or poor corporate governance by firms.

This research will trace the historical development of the legislation relating to the stock exchange up to the enactment of the new law (The Kuwait Capital Markets Act 2010 No. 7). The latter will be compared with similar legislation in the other markets of the GCC (as well as those in the USA and the UK when necessary) in order to evaluate its potential effectiveness in averting future problems and failures such as those that impacted Kuwait when it faced a financial crash in the early 1980s.

Hence, the main aim of this thesis is to evaluate the extent to which the Kuwaiti securities legislation (the Act) is effective in protecting individual investors in terms of insider dealing, unfair disclosure and poor corporate governance by the issuer of the securities., and to suggest any amendments. Apart from this aim, the thesis will hopefully help to improve the knowledge of the Kuwaiti people about securities and it is also hoped that the research will be a useful addition to the body of literature in this field and will open a new avenue of research for other Kuwaiti students to follow for the improvement and development of the national economy.

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Criminal Justice Act 1993

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Financial Services Act 2010

Financial Services Act 2012

Financial Services and Markets Act 2000

Fraud Act 2006

Investment Act 1958

USA

Insider Trading and Securities Fraud Enforcement Act 1988 (ITSFEA)

Sarbanes Oxley Act (SOX) 2002

Securities Exchange Act of 1934

Securities Act 1933

European

Directive 2006/46/EC of the European Parliament and of the Council of 14 June 2006 amending Council Directive 78/660/EEC in the annual accounts of certain types of companies, 83/349/EEC on consolidated accounts, 86/635/EEC on the annual accounts and consolidated accounts of banks and other financial institutions and 91/674/EEC on the annual accounts and consolidated accounts of insurance undertakings.

Directive 2013/34/EU of the European Parliament and of the Council of 26 June 2013 on the annual financial statements, consolidated financial statements and related reports of certain types of undertakings, amending Directive 2006/43/EC of the European Parliament and of the Council and repealing Council Directives 78/660/EEC and 83/349/EEC.

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The second one is the directive No. 2014/57/EC on the European Parliament and of the Council of 16 April 2014 on Criminal Sanctions for Market Abuse

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Directive 2004/39/EU of the European Parliament and of the Council of 21 April 2004 on markets in financial instruments amending Council Directives 85/611/EEC and 93/6/EEC and Directive 2000/12/EEC of the European Parliament and of the Council and repealing Council Directive 93/22/EEC.

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Law No.116 of 2013 regarding the Promotion of Direct Investment in Kuwait.

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Emiri Decree No 158 of 2005 concerning the amendment of some articles of the decree organising the Kuwait Stock Exchange

Law 35 of 2002 Regarding Combating Money Laundering Operations

Law No. 8 of 2001 regarding the regulation of Direct Investment of Capital in Kuwait.

Law No 20 of 2000 allowing non-Kuwaiti investors to own shares in Kuwaiti shareholding companies

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Law No 32 of 1970 Regulating the Negotiation and Transaction of Company Securities

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Kuwaiti Constitution 1960

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Saudi Arabia Anti Bribery Regulation 1991

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USA

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Rule 14e-3

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UK

UK Corporate Governance Code 2012

Code of Practice for Ministerial Appointment to Public Bodies 2012

Stewardship Code 2010

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Cady, Roberts & Co 40 SEC 907 (1961)

Chiarella v United States 445 US 222 (1980)

Dirks v SEC 463 US 646 (1983)

SEC v Adler 137 F 3d 1325, 1337 (11th Cir 1998)

US v O'Hagan 117 S Ct 2199, 2211 (1997)

US v Teicher 987 F 2d 112, 120-21 (2d Cir) cert denied, 510 US 976 (1993)

United States v Chessman, 947 F 2d 551 (2d Cir 1991) the Second Circuit

US v Newman 664 F 2d 12 (2nd Cir 1981)

UK

R v (1) McQuoid (2) Melbourne ([2009] Southwark Crown Court)

R v Holyoak, Hill and Morl (unreported)

R v Rigby and Bailey (2005) EWCA Crim 3487

Enforcement Decisions

UK

FCA 20/1/2015 an enforcement decision was taken by the FCA

FSA/PN/024/2013 an enforcement decision was taken by the FSA.

FSA/PH/031/2013 an enforcement decision was made by the FSA

FSA/PN/104/2012 an enforcement decision was taken by the FSA.

FSA/PN/015/2011 an enforcement decision taken by the FSA

FSA/PN/072/2011 an enforcement decision was taken by the FSA

FSA/PN/036/2010an enforcement decision was made by the FSA

FSA/PN/102/2010 an enforcement decision was made by the FSA

FSA/PN/011/2009 an enforcement decision was taken by the FSA

FSA/PN/015/2009 an enforcement decision was taken by the FSA

FSA/PN/056/2008 an enforcement decision was made by the FSA.

49(TCC) UKUT [2011] Upper Tribunal reference FIN/2009/0024 David Messey and
The Financial Services Authority

List of Abbreviations

AIM	Alternative Investment Market
BCBS	Basel Committee on Banking Supervision
BIS	Bank of International Settlements
BITs	Bilateral Investment treaties
CBK	Central Bank of Kuwait
CFEB	Consumer Financial Education Body
CISs	Collective Investment Scheme
CJA	Criminal Justice Act
DTR	Disclosure and Transparency Rules
FRC	Financial Reporting Council
FCA	Financial Conduct Authority
FINRA	Financial Industry Regulation Authority
FOS	Financial Ombudsman Services
FSMA	Financial Services and Markets Act 2000
FSA	Financial Services Authority
FSB	Financial Stability Board
FSCS	Financial Services Compensation Scheme
FPC	Financial Policy Committee
G20	Group of twenty finance ministers and central bank governors
GAAP	Generally Accepted Accounting Principles
GCC	Gulf Cooperation Council
IASB	International Accounting Standards Board
IFRSs	International Financial Reporting Standards
IMF	International Monetary Fund

IOSCO	International Organisation of Securities Commissions
KCMA	Kuwait Capital Markets Authority
KFIB	Kuwait Foreign Investment Bureau
KSE	Kuwait Stock Exchange
LSE	London Stock Exchange
LR	Listing Rule
MC	Market Committee
MiFID	Markets in Financial Instruments Directive
MOCI	Ministry of Commerce and Trade
OECD	Organisation for Economic Co-operation and Development
PRA	Prudential Regulation Authority
QCA	Quoted Companies Alliance
QFMA	Qatar Financial Markets Authority
RIS	Regulatory Information Service
SCMA	Saudi Capital Markets Authority
SEC	Securities and Exchange Commission
SIB	Securities and Investment Board
SROs	Self-regulatory Organisations

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Chapter One

Introduction

1.1 The aims of the thesis

In 1982, Kuwait experienced a financial crash which had a profound impact on investors and the economy. This was caused by securities trading in an anarchic way in a market devoid of regulation. Following the crash the government embarked on a programme of regulatory involving the introduction of several pieces of legislation over the years culminating in the Capital Market Act 2010. The events of 1982 prompted this research into whether the government's measures to afford better protection to investors compare favourably with the measures in place in other jurisdictions.

The research question which this thesis will try to answer is as follows. Does the Kuwaiti Capital Market Act 2010 adequately protect individual investors in shares of listed companies on the secondary market¹ of the Kuwaiti Stock Exchange (KSE) from insider dealing, unfair disclosure and poor corporate governance by the issuer of the securities?

In order to answer this question, the thesis will (a) examine the legal provisions of the Act aimed at regulating the above activities (b) examine other relevant legislation which also contains an element of protection for individual investors such as accounting law, company law and, fraud and bribery legislation (c) examine the operation and powers of the regulatory authority responsible for monitoring compliance with the legislation.

¹ Securities markets can be divided into two markets. The first is a primary market; the second is a secondary market. The former deals with the issuers' transactions (selling of securities by issuers), while the latter has trading transactions (buying and selling issued securities); Alan Palmiter, *Securities Regulation: Examples and Explanations* (6th edn, Aspen Publishers 2014) 1.

This thesis will not address the following areas of regulation:²

- Other forms of market abuse such as manipulation.
- Regulation of financial intermediaries and brokers.
- Other types of securities such as bonds and derivatives.
- Other types of financial markets and the primary capital market.
- Other types of investor such as institutional investors,

One of the aims of the law is to protect people and their property by regulating the conduct of individuals, businesses and other organisations in society.³ Paul Nelson said that ‘law is not a search for the truth. The latter is the province of physical sciences. Law, as a social science, is all about understanding and assisting people in their social relations’.⁴

Having social rules is one of the most important differences between human societies and animal groups.⁵ The law in the community serves as the heart in the body. Without the law, the human community collapses. The strong will control everything regardless of whether they have the right to do so, and the weak will have nothing.⁶ In general, law aims to protect people, ensuring that all citizens are subject to the law, and the law controls the state’s actions.

There are different ways of investing funds. The company or consumer who deposits money into an interest bearing account in a bank makes the simplest form of investment. After that investments range in complexity. Investors in shares face numerous risks from the conduct of companies, individuals within these companies or

² This will be explained in more detail later.

³ Henry R Cheeseman, *The Legal Environment Of Business and Online Commerce: Business Ethics, E-Commerce, Regulatory and International Issues* (7th edn, Pearson 2013) 3.

⁴ Paul Nelson, *Capital Markets Law and Compliance: The Implications of MiFID* (Cambridge University Press 2011) 7.

⁵ Phil Harris, *An Introduction to Law* (7th edn, Cambridge University Press 2007) 1.

⁶ Tamer Saleh, *Legal Protection for Securities Markets* (Dar New University 2011) 9.

other individuals whose behaviour can harm investors. This will be discussed in more detail in chapter two.

This thesis will only consider the risk arising from actions that either affect the traded share price or those which affect an investor's decision to buy or sell. The categorisation of this behaviour is jurisdiction specific. The actions or behavior which this thesis will deal with are insider dealing and unfair disclosure of inside information which are key targets for regulation in virtually every country. It would have been logical for completeness to consider manipulation as well as insider dealing. However the treatment of manipulation by the 2010 Act has already been adequately researched⁷ and the Act has not changed since the data of that research. Moreover, there has not been any case law in Kuwait which tests the adequacy of the Act in this area.

So this thesis will consider only the regulation affecting the two activities mentioned above. Moreover this thesis will not consider the risk to investors from the mis-selling of financial products or services by institutions or intermediaries or the risks from the lack of financial or commercial prudence on the part of any financial institutions or deposit takers. Nor will this thesis consider other types of financial crime such as money laundering, accounting fraud, dishonesty or corruption which have been at the root of corporate collapses and scandals in the late 1980s and 1990s. However the thesis will examine the measures, in the form of regulatory corporate governance provisions put in place to improve corporate accountability of listed company boards in the wake of these scandals. This will be discussed in more detail in chapter two.

Most, if not all, countries have regulation in place in order to try to protect investors from the various risks. Although shares are corporate financial instruments, corporate law alone has been found over the years to be inadequate for the purpose of protecting

⁷ A PhD research by Fatemah Al Shuruiain entitled 'Market Manipulation In Kuwait Stock Exchange: An Analysis of the Regulation of Market Manipulation Prior and Under Law 7 of 2010' (PhD dissertation, University of Leicester 2013) Available at:<<https://lra.le.ac.uk/bitstream/2381/28831/1/2013ALshurainFPhD.pdf>> accessed 17 November 2015

investors. It has therefore been necessary to introduce specialised securities legislation to try to remedy any shortcoming in corporate law. Furthermore, the enforcement of such legislation is in the hands of a regulatory body responsible for policing the securities legislation and for bringing any civil or criminal actions.

How civil⁸ and criminal liabilities are underpinned by legislation varies from country to country depending on the regulatory framework. For example, in the UK, insider dealing is criminalised in the criminal justice Act 1993 and civil sanctions for insider dealing and other financial crimes are contained in the Financial Services and Markets Act 2000 (FSMA). On the other hand in Kuwait, both civil and criminal liability are contained the Capital Market Act 2010. This thesis will only consider civil and criminal liability imposed by securities law but not liability incurred under private and criminal law in general.

To assist in this the law in Qatar, Saudi, the UK⁹ and/or the USA¹⁰ will be examined in order to see how Kuwait's Act could be improved. It might be argued that one only needs to compare Kuwait with more industrialised countries such as the UK which has a long history and experience of financial regulation. However Qatar and Saudi have also been included in the comparison since they are broadly at the same level of development as Kuwait, so they might have some things which are implemented differently to the UK taking into account the local culture and law. Moreover, including Qatar and Saudi has contributed further to the originality of the research which could be of interest not only to the Kuwaiti authority but also to the Qatari and Saudi authorities.

⁸ This thesis will not consider civil or tortious liability of a company to an investor by reason of the former's breaches of securities or other law.

⁹ The UK has a long history of dealing with these problems. Moreover, since 2000 the UK has adopted European Directives in this area therefore it is felt that the situation in the UK would be representative of the whole of the EU.

¹⁰ The USA will be considered only in connection with insider dealing (Chapter Three) because the history of insider dealing there is much longer than in other jurisdictions.

The primary aim of this thesis is to seek a detailed understanding of the Act in terms of protecting individual investors¹¹ focusing on whether it offers them appropriate protection¹² and, if applicable, suggesting amendments to the law. It is hoped that the research will be a significant addition to the body of literature in this field and of value to Kuwaiti legislators when considering amendments to the law.

Major economies, such as those in the United Kingdom (UK) and the United States (US), have legislation to ensure that investors are adequately protected. This legislation has evolved over the years in an effort to increase the level of protection. For example, in the UK, the Financial Conduct Authority (FCA) has two kinds of objectives. The first is a strategic objective to ensure that the relative markets¹³ function well. The second are operational objectives to secure an appropriate degree of protection for consumers,

¹¹ Article 3 of the Act concerning the establishment of capital markets provides:

The Authority aims to: 1. Organise the securities business in line with the principles of equity, efficiency, competitiveness and transparency. 2. Make the public aware of the security business and its benefits, risks and obligations associated with the investment in securities, and urge for the development thereof. 3. Provide protection for those involved in the securities business. 4. Minimise the standard risks expected to arise in the securities business. 5. Implement the full disclosure policy in a way to realise equity and transparency and to prevent conflicts of interest and insider trading. 6. Seek to ensure compliance with the laws and regulations related to securities activity.

It is important, therefore, to discover the protection provided by this law mentioned in Article 3, part 3.

¹² The word ‘invest’ comes from the Latin verb ‘*investire*’, which means to clothe and adorn. By 1613, as a result of developments in using the English Language, the word bore a financial connotation. Another meaning of the verb ‘to invest’ was used to point out the expectation of interest or profit from the employment of money, according to the Oxford Shorter English Dictionary; Jonathan Fisher, Jane Bewsey, Malcolm Waters, Elizabeth Ovey, *The Law of Investor Protection* (2nd edn, Sweet & Maxwell 2003) 5.

¹³ According to part 1A, section 1F of the Financial Services Act 2012, relative markets are ‘1- the financial markets; 2- the markets for regulated financial services; 3- the markets for services provided by persons other than authorised persons in carrying on regulated activities but provided without contravening the general prohibition’.

to protect and enhance the integrity of the UK financial systems,¹⁴ and to promote effective competition in the interest of consumers.¹⁵ By comparison with the UK and the US, the Gulf Cooperation Council (GCC) countries are still at the beginning of their evolutionary process to improve investor protection.

In Kuwait, during the financial crash period, there was limited regulation of stock exchange activities, although the financial market in Kuwait had existed longer than the financial markets in the other gulf countries. This gap in legislation was highlighted by the Suq al-Manakh crisis, when the absence of regulation resulted in heavy losses for large and small investors. This led the Government of Kuwait to enact a series of Acts from the late 1970s to 2010 as follows:¹⁶

- Law No 32 of 1970 Regulating the Negotiation and Transaction of Company Securities;
- Emiri Decree of 1983 Organising the Kuwait Stock Exchange;¹⁷
- Law 42 of 1984 Regulating Share Dealing and Securities Trading;
- Law 31 of 1990 Regulating the Trading of Securities and Investment Funds;

¹⁴ According to part 1A, section II of the Financial Services Act 2012, the UK financial systems includes ‘a) financial markets and exchanges; b) regulated activities; c) other activities connected with financial markets and exchanges’.

¹⁵ Financial Services Act 2012, pt 1A s 1B.

¹⁶ The explanatory memorandum to the Act states that the legislation that preceded the Act became the cornerstone in establishing the Kuwait Stock Exchange, contributed to the market’s revitalisation and economic development, and, over the past few years, led the market to become a leading regional market and the focus of attention of investors. Yet, several reasons were offered for changing the law. The first reason was to keep up with global developments in financial markets, such as, for instance, the fall of barriers and obstacles that hindered the movement of capital, from which emerged features of the new world order with competition and free trade. The second reason was to adapt to developments in the Kuwaiti stock exchange. Finally, the stock market operation revealed some shortcomings in the legal system and the legislative framework governing the stock exchange, especially the need to develop monitoring, to provide greater flexibility in dealing, to enhance procedures, to provide legal protection in the market, especially for small investors, and to reduce manipulation to make a profit illegally. It is important, therefore, to explore the protection afforded by this law by discussing and analysing the legal framework in the form of a comparative study.

¹⁷ The legislative basis regulating the stock exchange until the issuing of the Act.

- Law 11 of 1998 Associated Laws Licensing Investment Companies;
- Law 2 of 1999 Requiring the Disclosure of Significant Shareholdings;

The securities market was built around this legislation, which helped to stimulate the economy by attracting investors. However, the practical application of these laws brought to light some shortcomings in the regulation of the stock exchange¹⁸ and specifically the need for the legal protection of individual investors against the risk of loss due to market abuse of securities (manipulation and insider dealing). Accordingly, the 2010 Act was passed to regulate the administration of the stock exchange and the trading of securities.

The 2010 Act was passed to protect all investors local and foreign. However foreign investors have additional protection. First there are 80 Bilateral Investment treaties (BITs) between Kuwait and other countries around 28 of which are not in force and three have been terminated¹⁹. Secondly in 2013 Kuwait established a new independent body²⁰ called the Kuwait Direct Investment Promotion Authority²¹ that aims to improve the investment climate, fostering competitiveness and adding investment opportunities for local and foreign investors.²² This regulation provides other types of protection such as non discrimination between local and foreign investors, how to use, enjoy or disposal of investments and maintain a favorable environment for investment. These types of additional protection are beyond the scope of the thesis because the thesis will just focus on securities law.

¹⁸ The Kuwaiti legislature has defined Stock Exchange as follows: ‘A Stock Exchange Market is the place where stocks and other securities are bought and sold. A Stock Exchange Market follows the procedures applicable to trading and carries out the usual functions of a stock market in accordance with the standards and regulations issued by the Authority’ Kuwaiti Capital Markets Act 2010, Article 31.

¹⁹ <<http://investmentpolicyhub.unctad.org/IIA/CountryBits/112>> accessed 4 October 2015

²⁰ This authority replaced the Kuwait Foreign Investment Bureau (KFIB) which was established under the Law No. 8 of 2001 regarding the regulation of Direct Investment of Capital in Kuwait.

²¹ <<http://www.kfib.com.kw/>> accessed 4 October 2015.

²² Law No.116 of 2013 regarding the Promoting of Direct Investment in Kuwait.

The research will trace the historical development of the legislation relating to the stock exchange up to the enactment of the Act and will evaluate that law and generate recommendations and amendments required to enhance its effectiveness. Therefore, the research mainly aims to assist the legislature of Kuwait in reforming legislation to benefit those who invest their savings in the stock market, so as to revitalise investment by protecting investors against sudden fluctuations due to fraud in the market and other threats. Indirectly, the thesis also aims to improve the Kuwaiti people's knowledge about securities, to enhance their general knowledge and understanding of securities law, and to open a new field of research to be explored by other students for the improvement and development of the national economy.

1.2 The benefits of the thesis

Stock exchanges are at the same time important and dangerous, possessing the potential to develop a country or to destroy it. A clear example of the potential danger is shown by the Suq al-Manakh Crisis, which will be discussed in detail later.

There are two potential benefits of this research. First to highlight any weaknesses in detail of the 2010 Act in terms of the protection which it affords individual investors in securities so that the Act can be improved. Secondly to provide original research which will be of interest and benefit to scholars, policy makers, government officials, law enforcement and others with an interest in this area in Kuwait.

1.3 Methodology

There are a number of legal research methodologies, and one tries to select a methodology to suit a particular thesis. In addition, arguably, a piece of research can include more than one type of methodology. Therefore, it is difficult to find a single,

perfect or correct methodology. Moreover, ‘there is no wrong or right methodology’.²³ Rather, a methodology is chosen to achieve the aims of a thesis.

Solving legal problems and finding the best way to apply special laws can be highlighted by using a comparative legal analysis. This type of methodology helps scholars to look outside of a country’s laws to understand how other jurisdictions deal with similar problems and how they develop their laws and rules.²⁴ The significant increase in the importance of comparative law in the present era is well documented. Comparative law means the comparison of diverse laws of different nations around the world. According to Zweigert and Kotz, the use of a comparative approach to the study of law started to develop in Paris around 1900 and it is still an approach which is now widely used.²⁵

The use of a comparative law approach is appropriate when people are at similar stages of economic development and culture. This can be found in the GCC countries, which share the same language, customs and history and are located near to each other. However, a comparison with more developed countries is beneficial in order to learn from their experience. As a result, the use of a comparative law approach in this thesis helps to determine which laws and regulations are the best. The use of a comparative law approach can produce a wide range of model solutions, because the different laws can provide a variety of answers to difficult issues. This variety enriches and expands the supply of solutions, increases the opportunity to discover the best solution, and is beneficial for legal reform. Without the assistance of a comparative law approach, it would be difficult to reform legislation and to develop new laws.²⁶

This thesis will be underpinned by a comparative legal analysis of the laws and rules of the GCC countries relating to securities in an effort to improve Kuwaiti law and

²³ Caroline Morris and Cian Murphy, *Getting a PhD in Law* (Hart 2011) 40.

²⁴ *ibid* 37.

²⁵ K Zweigert and H Kotz, *An Introduction to Comparative Law* (3rd edn, OUP 1998) 3.

²⁶ *ibid* 15.

regulation. Accordingly, the study will attempt to identify the shortcomings in the Act that need to be remedied by comparison with similar securities laws of the GCC. In some areas within this thesis, the comparative law approach will be extended to some developed countries, such as the US and the UK. For example, the US has a long history and good experience of banning insider dealing. Therefore, it is wise and useful to discuss the American regime in connection with insider dealing. In addition, the UK has passed legislation in this area, such as the Financial Services and Markets Act 2000 (FSMA) and the Criminal Justice Act 1993. In the field of financial regulation, both the UK (common law system)²⁷ and the Gulf (civil and Shari'ah legal system) have clear rules despite having different legal systems, which has made a comparison easier.

Extensive use will be made of primary sources, such as legislation and regulatory rules, to achieve the objectives of this thesis. These laws and rules will be compared and analysed as well as reports from international institutions, and, where applicable, legal precedents established by the courts. Textbooks, journals and relevant websites published by legal experts and other scholars relating to the subject of this thesis will also be discussed to enrich the search. The Oxford Standard for the Citation of Legal Authorities (OSCOLA-Fourth edition)²⁸ has been adopted with regard to thesis style, bibliography and footnotes. .

1.4 Organisation of the thesis

To achieve the aims of this study, this thesis is divided into seven chapters.

The first chapter covers the aims of the thesis, its benefits and the methodology used. It also addresses the difficulties and limits of the thesis, the historical developments of the

²⁷ For example, in the UK, an act of parliament is higher than case law. In common law system countries such as the UK, parliament can be described as the highest law-making court above any other. Ulrike Muessig, 'Superior Court in Early-Modern France, England and the Holy Roman Empire' in Paul Brand and Joshua Getzler (eds), *Judges and Judging in the History of the Common Law and Civil Law* (CUP 2012) 220.

²⁸ <www.law.ox.ac.uk/oscola> accessed 24 December 2012.

Kuwait Stock Exchange, the Suq al-Manakh Crisis, the historical development of the stock exchange in the Arabian Gulf Region and the historical development of legal systems in Kuwait, Qatar and Saudi Arabia. Chapter Two will discuss the concept of protecting investors under securities law, which has four elements: the investors, the securities, the securities law and the protection of investors. Each of the elements will be introduced. Some countries, such as the UK, regulate securities as a part of the whole financial system called 'Financial Regulation', while other countries, such as the GCC, regulate securities in separate and special laws called 'Securities Laws'. An introduction to financial regulation and other laws that protect investors will be presented. This chapter will discuss the protection of retail investors and small, private and individual investors on stock exchanges in secondary markets. The ways of protecting the securities market differ from the ways of protecting the traditional market. This chapter will consider how to protect investors in securities markets and the areas of protection, because there is no clear definition of 'protecting investors'. This chapter will outline the risks that investors face. The first task is to find a fair share price that has not been influenced by market abuse (insider dealing). The second task is to give investors access to information on which they can make informed buying or selling decisions. The third task is to protect investors from bad behaviour by managers. The body of law dealing with this is known as corporate governance law and it spans different pieces of legislation. This thesis will only consider the corporate governance provisions contained within securities legislation. The fourth is to have sound securities regulation in place.

Chapter Three considers insider dealing as an example of market abuse on the stock exchange. The background to and the debate surrounding insider dealing will be discussed. The existing legal framework for the regulation of insider dealing in the Kuwait, Qatar and Saudi stock markets will also be discussed in this chapter. It will look at the experience of the US and the UK in this field with a comparison between the American and the British regimes. There are three important issues which must be addressed to deal effectively with insider dealing: the definition of insider dealing, the sanctions which should be available and the method of enforcement of these sanctions under securities law.

Chapter Four will focus on the disclosure of inside information by listed companies, because fair disclosure is one way to protect investors by ensuring that all investors have equal opportunity to access and be aware of information that is likely to affect the share price in an appropriate time and way. This chapter will examine the existing disclosure rules which apply to equity shares in Kuwait compared to the disclosure regime in Qatar, Saudi and the UK as an example of developed countries. This chapter will define inside information in each jurisdiction studied and will set out a suitable time for information disclosure. Delay in full disclosure, limited disclosure, initial and final disclosure, exemption from disclosure, and dealing with rumours will all be addressed. Ways to improve the disclosure regime will be analysed in this chapter. Since laws must punish those who breach the information disclosure regime, the criminal sanctions and the administrative sanctions under securities law available will also be considered.

Chapter Five is about corporate governance of listed companies under securities law. This chapter will define corporate governance and review some of its better known failures. It will review some of the corporate governance principles in existence in the UK, Saudi and Qatar, and the enforcement methods in the UK, to compare them with measures in place in Kuwait with a view to determining whether the latter adequately protect investors.

Chapter Six will focus on having a sound regulatory authority. For a regulatory authority to protect investors effectively, it must be independent, introduce sound regulation and create strong investors, all of which will be discussed. This chapter will look at the regulatory authority in the UK, because securities authorities in Kuwait, Qatar and Saudi were established only recently. To assess their adequacy, it is helpful to compare them with a system such as the UK, which has existed for much longer. The soundness and independence of the regulatory authority in Kuwait will be assessed in terms of its composition, funding arrangements, accountability and freedom of action from political and commercial interference. A regulatory framework that protects investors must have laws, rules and codes. This chapter will consider how a regulatory authority can help to combat more effectively the crime of insider dealing. It will study

what is sometimes referred to as ‘Hard Law’, which includes rule making, and so-called ‘Soft Law’, which refers to statements of principles, codes of conduct, codes of practice and guidance. A regulatory authority can play a significant role in ensuring that investors receive clear and adequate information about the market, the risk and their rights. This will be discussed in this chapter. Chapter Seven will conclude the thesis.

1.5 Difficulties

Undertaking the research for this thesis was made more complicated for three reasons. First, securities law is among the most complex and misunderstood areas of law. There are a lot of conflicting ideas about securities law. Not surprisingly, some describe securities law as a puzzle.²⁹ Secondly, in GCC countries, this subject is poorly documented. These factors have made this study more complicated. Nevertheless, investors in these countries need be aware of the law and the limited protection that it affords them, which requires that securities law be studied and analysed by students and experts.

Another difficulty of this research is that financial laws and regulations in the markets under consideration namely the UK and the Gulf have been continually changing during the course of this research, especially because of the global financial crisis of 2008. Many laws have been passed by governments and global institutions to make financial regulation more effective. For example, the financial regulatory system in the UK was restructured and some of the Gulf countries, notably Qatar, passed a new law in 2012 which repealed the law of 2005.

²⁹ Securities law has a reputation for being one of the most difficult areas of law. In particular, the Securities Act 1933 in the US is so complex that students and lawyers cannot master it on their own; Larry Soderquist and Theresa Gabaldon, *Securities Law* (5th edn, Foundation Press 2014)1.

1.6 Scope of the Research

This thesis will concentrate on how best to protect an individual investor who buys shares in a listed company on a stock exchange on a secondary market and not on a primary market where shares are initially offered. It is beyond the scope of this research to look at protection in the primary market because the protection techniques are different from those of a secondary market. The research will not address the protection of individual investors from the risk associated with the purchase of financial products offered by deposit takers, insurance companies and any other financial services companies, nor will it address any compensation mechanisms such as the Financial Services Compensation Scheme (FSCS) in the UK. This thesis will also not cover the methods of protection of investors from the actions of financial advisers. Therefore, the scope of this thesis will be limited to five points: shares, stock exchange, secondary markets, listed companies and individual investors.

The major share of market trading in GCC countries is by individual investors. For example, in Kuwait,³⁰ the volume traded by individual investors is approximately 60% of the whole official market trade,³¹ while in developed countries the major share of the market is held by institutional investors. For example, in the UK individual shareholders own approximately 11.5% of the equities, while in the 1960s the percentage was approximately 54%.³²

Individual investors and listed companies will be discussed in Chapters Two and Four, respectively. The following sets out the definition of shares and some ideas about stock exchanges and secondary markets.

³⁰ <<http://www.kuwaitse.com/A/KSE/TradeVolReport.aspx>> accessed 23 April 2014.

³¹ For the trading period from 1/1/2013 to 30/11/2013.

³² The Key Review of the UK Equity Markets and Long Term Decision Making: Final Report <https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/31544/12-631-kay-review-of-equity-markets-interim-report.pdf> accessed 20 May 2014.

1.6.1 Shares

Although there are many different types of shares, this thesis will focus on ordinary shares known as ‘equities’. In the UK, stocks means the same as shares. The table below (Table 1.1) shows different types of share.³³

Name	Definition
Ordinary shares	Each ordinary share has an equal stake in the company and one equal vote.
Preference shares	Investors receives a set rate of interest like loans. Their dividend should be paid before ordinary shares. In the event of liquidation, preference shares should be paid off before ordinary shares.
Ordinary shares with additional rights	These different classes carry differing rights to vote or for dividends or to participate in the surplus on a winding up.
Convertible shares	Convertible to debt in some circumstances.
Golden shares	Outvote all other shares put together. Used by the government when the national interest is at risk in a privatised company.
Vendor shares ³⁴	In an acquisition matter, instead of paying cash, a company issues new shares to be given to the seller.

Table 1.1 Types of Shares

The main benefits derived from buying shares include capital gain (growth),³⁵ income (dividends),³⁶ and the ability to convert shares to cash quickly.^{37, 38} Owners of ordinary

³³ Rodney Hobson, *Shares Made Simple: A Beginner's Guide to the Stock Market* (2nd edn, Hamman House 2012) 3-8.

³⁴ *ibid* 10.

shares share profit (dividends), vote in company decision-making, and have the right to attend an annual meeting.³⁹ Usually, the buyers of ordinary shares in particular companies will be the part-owners of those companies.⁴⁰ However, there is a debate about whether the shareholder just owns the profit while the company owns itself, but this is outside the scope of the thesis.

On the other hand, although shares have a better return over a long period of time than other main investment types (namely bonds, cash, and property), there are three risks. There is no legal right to receive a dividend. The company can either distribute profits or reinvest them in their business or use them for an acquisition.⁴¹ The second risk is the economic risk arising when the share price drops if people change their ideas about the company and they no longer want to invest in it, or when a company does not perform as expected. In recent years another type of risk has arisen known as a legal risk against

³⁵ This means when the companies increase in value, the share price will usually go up and they will be worth more.

³⁶ Dividends are an income similar to interest. However, interest is paid to depositors who place their money in a bank, while dividends are paid to shareholders who buy shares of a company. Deposits in a bank pay an income which depends on interest rates. It is automatic. No one needs to approve it. While dividends from shares are not automatically paid if the company makes a profit. It is up to the board.

³⁷ This means owners of shares have the right to sell their shares at any time during the listing period in a stock exchange in an easy way.

³⁸ Thomas Anthony Guerriero, *How to Understand and Master Securities Laws & Regulations* (E- Books 2012, iPad) 78.

³⁹ Rodney Hobson (n 35) 3.

⁴⁰ It is generally accepted that the separation of ownership and control of the company is at the root of the corporate governance problem. How owners and managers interact with each other is the subject of different theories, the most popular of which is the agency theory. Agency theory describes the relation between shareholders and managers as a contractual one similar to that between a principal and an agent where the latter has a fiduciary duty to the former. However, it is debatable whether shareholders are actually owners of the company. Lynn Stout stated that shareholders own a share but the company owns itself. It is a separate legal unit and according to company law, directors owe a fiduciary duty to the company. Lynn Stout, 'Corporate governance- what do shareholders really value?' (YouTube) <<http://www.youtube.com/watch?v=s5Eoy988728>> accessed 20 May 2014.

⁴¹ Iain G Macneil, *An Introduction to The Law on Financial Investment* (2nd edn, Hart Publishing Ltd 2012) 134.

the company, which can be defined as a risk of legal action and the fining of a company, all of which affects the share price.⁴² The three previous risks are beyond of the scope of the thesis because they cannot be avoided.

There are also risks associated with the method of buying shares. There are two ways to buy shares, namely direct or indirect purchase. When a person wants to buy shares directly, they usually do it through a traditional broker, online broker, or through a financial adviser or investment manager who will in turn go through a traditional broker.⁴³ Indirect buying is when people pool their money with other people so the shares will be chosen by a professional fund manager. Indirect investment is known as a fund. Fund investment and other types of collective investment scheme is beyond the scope of the thesis because it carries different types of risks which need different types of protection.

1.6.2 Stock Exchange

An 'exchange' is defined as 'a marketplace in which securities, commodities, derivatives and other financial instruments are traded'.⁴⁴ Shares are traded at a stock exchange. Stock markets differ significantly from other commercial markets, as a result the effective performance of stock markets demands the implementation of a regulatory framework in the form of securities regulations. These are unlike the laws that govern other ordinary, non-securities related commercial dealings. The question here is: why do stock exchanges need to be regulated?

1.6.2.1 Is Regulation of a Stock Exchange Necessary?

⁴² *ibid* 24-25.

⁴³ < <https://www.moneyadviceservice.org.uk/en/articles/investing-in-shares> > accessed 17 January 2015.

⁴⁴ Thomas Anthony Guerriero (n 40) 58.

Whether regulation is necessary or not depends on one's point of view. People who are against market regulation believe in the co-called 'Efficient Markets Theory', which holds that 'the stock prices always reflect all available information and are efficient prices'.⁴⁵ This means that no one can achieve extraordinary profits at the expense of another party. Prices are always equal to the true value of the assets. The prices are the outcomes of the views of all investors. The Efficient Markets Theory is based on the laws that describe the behaviour of markets where the price is set by supply and demand and by external shocks, which, in financial markets, means new information.⁴⁶ This theory does not take into account price movements that might result from market abuse, for example.

One critic of this theory is Robert Shiller, who says that the Efficient Markets Theory is only half true. He questions the assertions that securities prices reflect the true value of assets.⁴⁷ Another critic, George Cooper, also criticised the Efficient Markets Theory as more faith than fact and asserted that it does not work for all markets.⁴⁸ In financial markets, a power pushes the markets away from equilibrium that causes 'financial markets to behave in a way that is inconsistent with the theory of efficient markets'.⁴⁹ In financial markets, the forces pushing the price are not explained by the Efficient Markets Theory. For example, in financial markets lack of supply leads to an increase in demand, and asset prices move because of increased demand.⁵⁰ He blames the academic community for promoting the Efficient Markets Theory to self-regulate markets.⁵¹ The reality is that regulation is necessary.

⁴⁵ *ibid* 156.

⁴⁶ George Cooper, *The Origin of Financial Crises: Central Banks, Credit Bubbles and The Efficient Fallacy* (Harriman House 2010) 9.

⁴⁷ Robert Shiller, *Efficient Markets* (Open Yale Courses, iPad, itunes U).

⁴⁸ George Cooper (n 48) 4.

⁴⁹ *ibid* 158.

⁵⁰ *ibid* 14.

⁵¹ *ibid* 175.

George Cooper cites Hyman P. Minsky's theory known as the 'Financial Instability Hypothesis' as a reason why regulation is necessary. The most important difference between this theory and the Efficient Markets Theory is the forces that cause the prices to move. The latter theory mentions that any change of price is a result of external shocks, which, in financial markets, is new information. However, the former theory states that, in addition to external forces, there are internal forces that do not lead financial markets to stability, to self-optimising or toward a natural optimal allocation of resources.⁵²

Economists spend their lives formulating theories about things: in this case, markets and their regulation. This thesis is not an academic discussion about such theories. The need for regulation is obvious, as evidenced by numerous financial crises and scandals, from which Kuwait is not immune. Regardless of the theories, the reality is that financial crises have occurred, people have suffered as a result, and this could have been avoided by having sound regulations in place. There is a greater development toward intervention in and regulation of the markets.⁵³

In the financial literature the risks facing investors can be divided into two main types, see the diagram below (Figure 1.1). The first one is direct risks which arise from market abuse, irresponsible actions by individuals or companies and poor corporate governance by companies. The second is indirect risks which are due to the instability of the financial system. For instance, if a bank goes bankrupt then it affects investors indirectly. This thesis will focus only on the former risks.

⁵² *ibid* 13.

⁵³ Mathieu Deflem, *Sociology of Law Vision of a Scholarly Tradition* (CUP 2010) 152.

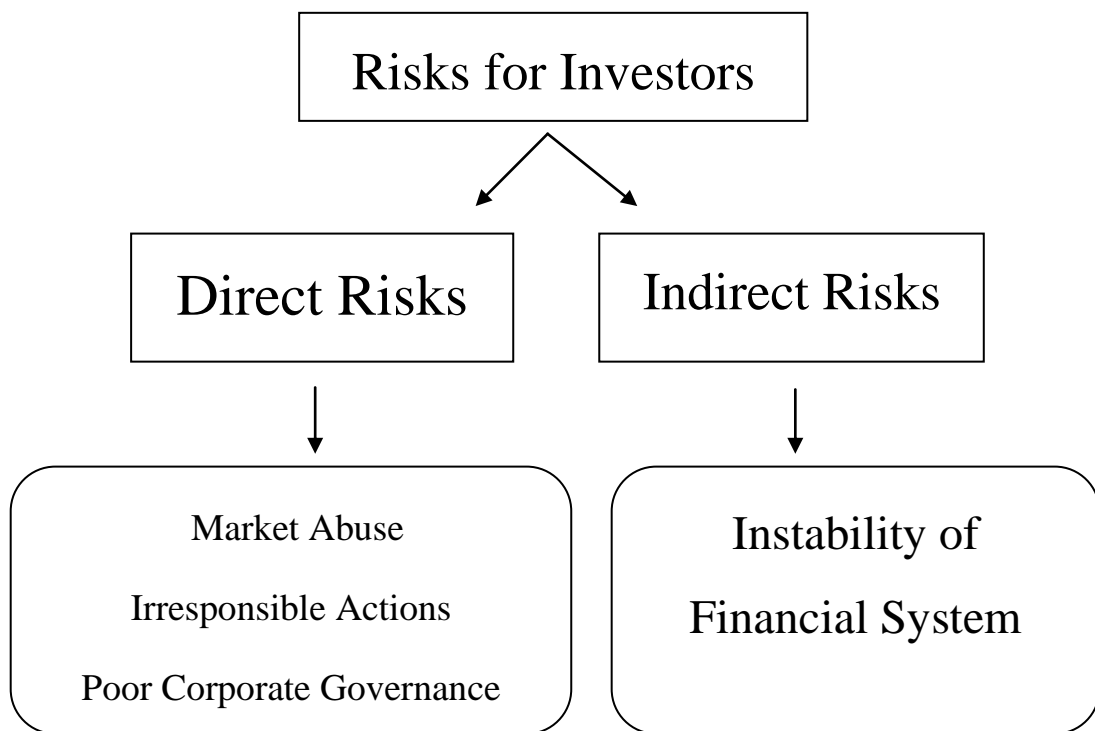


Figure 1.1 stylised diagram of types of risks facing investors

Three main types of direct risks are cited in the financial literature. One is the risk that someone will abuse the market. Examples of this are insider dealing or manipulation of the share prices or supplying false information. The second type of risk is due to irresponsible actions, usually by companies who do not disclose information on time or make incomplete disclosure. The third type of risk is from poor corporate governance where managers misbehave.

Protection against these risks is provided by different types of regulation. Protection against market abuse is by means of hard law. This consists of primary legislation such as acts of parliament and secondary legislation which is legislation delegated by an act of parliament. Secondary legislation consists of so-called Rules. It is very useful because it is speedy and saves parliament time. It is passed by people who understand the subject and it has the power to impose fines without going to court. Irresponsible actions are also dealt with by hard law in the form of secondary legislation. Corporate governance, on the other hand, is protected by so-called Soft Law. It is considered to be ‘soft’ because an offender cannot be jailed or fined. This soft law consists of voluntary

codes. Hard and soft law are commonly known as securities laws and will be discussed later in more detail. Figure 1.2 shows Stock Market Investors' Direct Risks and Protection Methods. This research will examine insider dealing, unfair disclosure and poor corporate governance risks in Kuwaiti securities law and find the best way of avoiding them.

Stock Market Investors' Direct Risks & Protection Methods

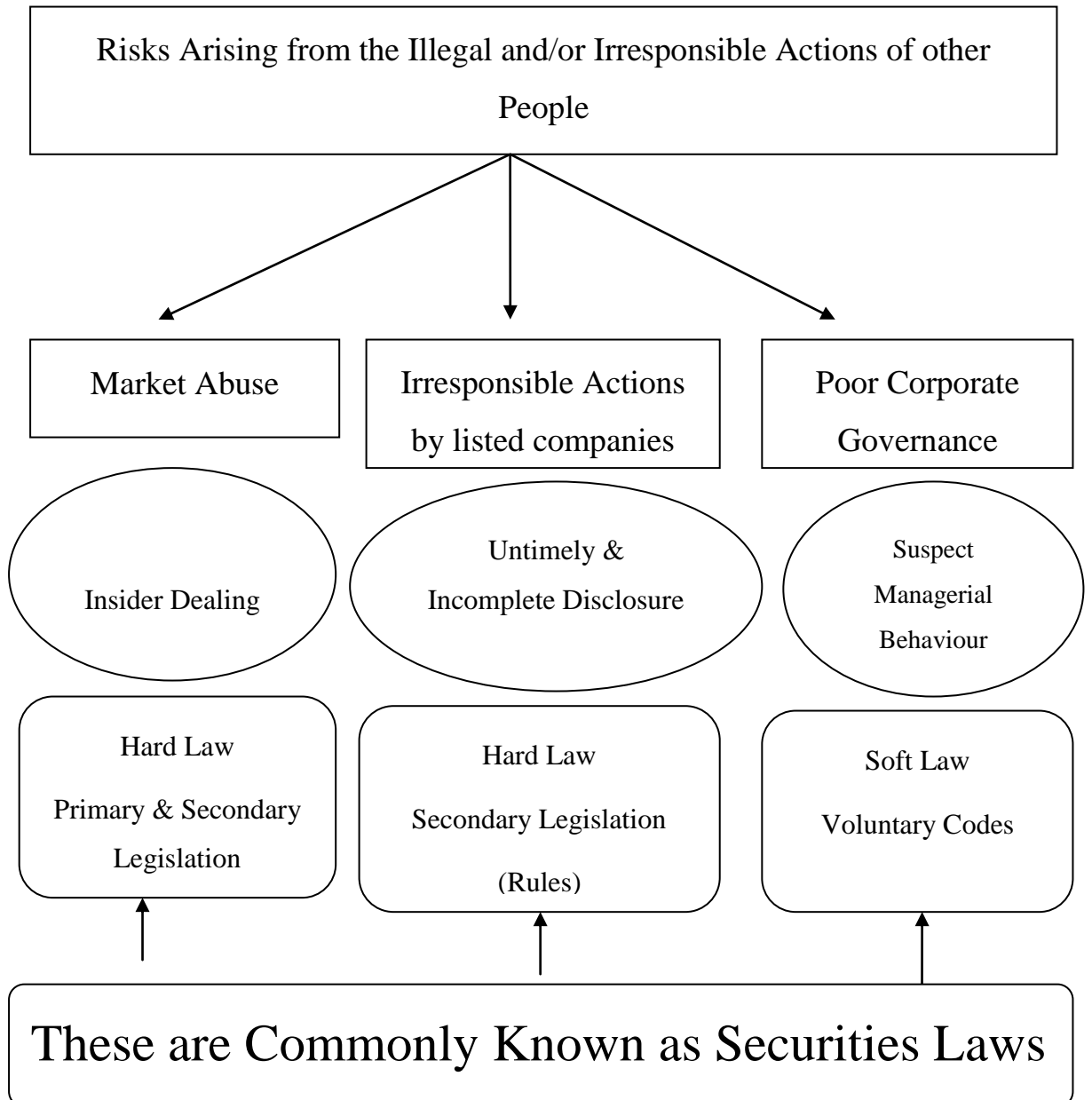


Figure 1.2 stylised diagram of the Stock Market Investors' Direct Risks and Protection Methods.

One risk alone, insider dealing, provides ample justification for regulating the stock exchange. In the UK, in connection with insider dealing, the Financial Conduct Authority (FCA) has secured 24 convictions between 2009 and 2014.⁵⁴ However, in Kuwait there has been none related to insider dealing. The reason for this could be due to the complexity and the long time required to prosecute insider dealing cases. This will be discussed in more detail in chapter three. The FCA's Director of Enforcement and Financial Crime, Tracey Mcdermott, emphasises this by saying 'Insider dealing investigations are complex and long running. Nevertheless we are committed to undertaking the painstaking analytical work which is required to bring these cases to court'.⁵⁵

There are many other examples that show the need to regulate the stock exchange related to insider dealing, irresponsible actions and poor corporate governance which will be discussed later in more detail. Therefore, regulation of a stock exchange has the potential to reduce or prevent these kinds of risks.

Nowadays, financial markets (including stock exchanges) have become more complex because of technological development, innovative financial instruments and globalisation. This increases the need to regulate the stock exchange in order to protect individual investors. Without regulating the market individual investors would suffer, but the question here is how to regulate the stock exchange?

1.6.2.2 How Should the Stock Exchange be Regulated?

There are several models for regulating stock exchanges. Initially, there was self-regulation. The nature, scope and structure of self-regulation have changed greatly over the last twenty years and there is no clear definition of it. There is a range of self-regulatory forms the world over. Sometimes, the term self-regulation is used to refer to

⁵⁴ <<http://www.fca.org.uk/news/former-moore-capital-trader-pleads-guilty-to-insider-dealing>> accessed 17 January 2015.

⁵⁵ *ibid.*

formal self-regulatory organisations (SROs). An SRO can be described as ‘a private institution that establishes, monitors compliance with, and enforces rules applicable to securities markets and the conduct of the SRO’s members.’⁵⁶ An SRO is ‘a non-governmental organisation that has the power to create and enforce industry regulations and standards’.⁵⁷ It is half-way between no regulation and state regulation, under which the state specifies, administers and enforces the regulations. Any person who wants to be a member of the SRO must be prepared to follow its rules.⁵⁸

SROs, such as stock exchanges, govern themselves without outside interference, especially if they are responsible for the operation of the exchange. This includes: 1) regulating market transactions, including ensuring that the members’ actions are in accordance with pre-agreed rules; 2) regulating the market participants by ensuring that they do not breach their obligations and that they maintain the value of their capital over time, that they do not take excessive risk, that they do not breach ethical behaviour, and that if they breach their obligations, they face sanctions from the SRO itself; and 3) that dispute resolution and enforcement actions are provided, including private mechanisms that enforce good conduct.⁵⁹ In some cases, the internal statutory rules involve determining the financial sources, managers’ and employees’ codes of conduct, oversight procedures and the formal structure of the SROs.⁶⁰

Self-regulation has a number of advantages: 1) greater ability to monitor effectively; 2) members of an SRO may have more interest in keeping the market safe and in

⁵⁶ John Carson, ‘Self-Regulation in Securities Markets’ (Working Paper for World Bank Financial Sector Policy Group 2010) 1.

⁵⁷ Thomas Anthony Guerriero (n 40) 58.

⁵⁸ Ruben Lee, *What Is An Exchange? The Automation, Management, and Regulation of Financial Markets* (OUP 2000) 129.

⁵⁹ Biagio Bossone and Larry Promisel, ‘The Role of Financial Self-Regulation in Developing Economies’ (The World Bank) <<http://www1.worldbank.org/finance/html/self-regulation-in-developing-.html>> accessed 6 April 2014.

⁶⁰ *ibid.*

preserving its integrity; 3) members of an SRO have more knowledge, expertise and experience about the market; and 4) the SRO has more flexibility.⁶¹

It would be better if the responsibility for designing the features of operational rules and the way of processing them were performed by SRO members because of their experience, knowledge and commercial interests. However, competition could suffer if the members were to transform themselves into cartels (conflicts of interest). Also, with limited competition, the SROs could be more flexible in applying rules, such as the listing rules.⁶² This flexibility will be discussed in Chapter Four.

Recently, many countries have transferred in different degrees some of the power and responsibility for regulation from the exchanges to a public regulator, which means that there is reduced reliance on exchanges as self-regulatory organisations (SROs).⁶³ Consequently, there are now four models of self-regulation involving the exchange and the regulator. The first is the ‘Government Model’, in which securities regulation lies with a public authority, and the exchanges have a limited supervision of their markets. This has occurred because of the movement of stock exchanges from non-profit making to being profit based and in many instances operating as listed company.⁶⁴ The second is a ‘Limited Exchange SRO’, in which a primary regulator is a public authority, and the exchanges are responsible for operating functions, such as listing and supervising the markets. The third is the ‘Strong Exchange Model’, in which a primary regulator is a public authority and the exchanges have more operating functions, which include regulation of member conduct. The fourth is an ‘Independent Member SRO’, in which a

⁶¹ Ruben Lee (n 60) 190-191.

⁶² Biagio Bossone and Larry Promisel (n 61).

⁶³ There are four important types of SROs in capital markets. The first are exchange SROs, such as securities exchanges with self-regulatory responsibility. The second are independent SROs, such as securities brokers or other intermediaries. The third are industry associations, such as bodies that provide best practices or guidance for members. The fourth is comprised of Central Securities depositories (CSDs) and clearing agencies. Exchange SROs are the most common in securities markets. <<http://www.world-exchanges.org/insight/views/self-regulation-securities-markets>> accessed 18 June 2015

⁶⁴ Iain G Macneil (n 43) 24-25.

primary regulator is a public authority that relies on an independent SRO for regulatory functions.⁶⁵

Nowadays many developed countries regulate their financial markets using the ‘Government Model’ mentioned previously.⁶⁶ This is the case in Kuwait, where the Kuwait Stock Exchange is a self-regulatory organisation, and the Capital Market Authority represents the government.

Therefore, it can be seen that because of the specialised nature of the topic, countries have found over time that in order to regulate dealing in the financial markets (including stock exchanges), it is better to appoint a “financial authority” with rule-making and investigative power, and the power to enforce the securities laws through prosecution and/or the imposition of sanctions.

1.7 The Historical Development of the Kuwait, Saudi and Qatar Stock Exchanges

The GCC⁶⁷ is a recent organisation of states when compared with developed countries. The discovery of oil caused significant political, economic and cultural developments. Consequently, these countries achieved a modern status virtually overnight. The most significant occasion in the history of the GCC states from an economic standpoint was the discovery of oil and natural gas in the region.

⁶⁵ John Carson (n 58) 1-3.

⁶⁶ ‘Self-Regulation In Today’s Securities Markets: Outdated System Or Work In Progress?’ (2007) Working Paper, CFA Institute for Financial Market Integrity.

⁶⁷ The birth of the GCC occurred in 1981. Its members are Bahrain, Kuwait, Oman, Qatar, Saudi Arabia and the United Arab Emirates (UAE), which are located on the three continents of Asia, Africa and Europe. The land comprising these countries is rich in oil and natural gas.

The leaders of the State of Kuwait, the State of Qatar, the Kingdom of Saudi Arabia, the United Arab Emirates, the State of Bahrain and the Sultanate of Oman met on 25 May 1981 and reached a cooperative framework joining the six states. Article 4 of its Charter sets out the GCC's basic objectives. The first goal is to coordinate, integrate and inter-connect the Member States in all fields to achieve their unity. The second goal is to deepen and strengthen the relations, links and areas of cooperation now prevailing between their citizens in various fields. The third objective is to formulate similar regulations in various fields, such as economics, financial affairs, commerce, customs, communications, education and culture. The last goal is to stimulate scientific and technological progress in the fields of industry, mining, agriculture, water and animal resources; to establish scientific research; to establish joint ventures and to encourage cooperation by the private sector for the good of their citizens.⁶⁸

The Gulf stock exchanges are much younger than the stock exchanges in more developed countries. For instance, the London Stock Exchange opened in 1773,⁶⁹ whereas the first GCC stock exchange opened two centuries later in 1977.⁷⁰ The establishment of public companies differed from one gulf country to another. For example, in 1952 the National Bank of Kuwait was the first local public company to be established in Kuwait. As a result, Gulf countries do not have a long history related to stock exchange markets.

This research will focus on two countries in addition to Kuwait, because the scope of the research would be too wide if other gulf countries were included. Therefore, it was decided to limit the number of GCC countries, but to include major industrial countries such as the UK and the USA when necessary. Saudi Arabia and Qatar were chosen for analysis because they have two of the highest rates of GDP growth and more recent legislation than any others. The table below (Table 1.2) shows the percentage of GDP

⁶⁸ < <http://www.gcc-sg.org/eng/indexfc7a.html?action=Sec-Show&ID=1> > accessed 5 June 2012.

⁶⁹ Ranald Michie, *The London Stock Exchange: A History* (OUP 2001) 33.

⁷⁰ The first stock exchange was opened in Kuwait in 1977. The Bahrain stock exchange was established in 1987.

growth and the year capital market laws were passed in the GCC countries. Moreover, Saudi Arabia is one of the group of twenty finance ministers and central bank governors in the G20 group. Therefore Saudi and Qatar are a good representation of the systems in the Gulf region.

Name of country	GDP growth for 2014 ⁷¹	Year of passing a Capital Market Law
Qatar	6.6%	2012
Saudi	6.8%	2003
Kuwait	5.1%	2010
Bahrain	3.9%	2002
UAE	3.9%	2000
Oman	5.0%	1998

Table 1.2 the percentage of GDP growth and the year of passing capital market laws related to the GCC countries.

The following section describes the Kuwaiti, Saudi and Qatari stock exchanges.

1.7.1 Kuwait

No transactions involving securities occurred in Kuwait until the end of the Second World War, when oil was discovered. The first cargo of crude oil was exported in 1946. The discovery of a vast supply of oil significantly transformed the lives of the Kuwaiti people, who previously lived simply. Before oil, the Kuwaiti economy relied on the pearl trade, maritime transport, and fishing.⁷² A tribe of Bedouins lived in the desert and herded sheep and camels. Since 1946, oil has dominated the

⁷¹ <<http://www.heritage.org/index/>> accessed 15 January 2015.

⁷² Hazem El-Beblawi and Raed Fahmy, *Kuwait's Stock Market* (Chamber of Kuwait Commerce and Industry 1982) [6] 22.

Kuwaiti economy and has ultimately displaced traditional activities.⁷³ Land trade and real estate were the main forms of wealth during the transitional period.⁷⁴

After this period of transition to an oil economy, the first Kuwait public company was established in 1952, which was called the National Bank. The National Cinema Company and the Kuwait Oil Tankers Company were established in 1954 and 1957, respectively.⁷⁵ In 1960, the Commercial Companies Act No. 15 was passed to encourage people to invest, and the government established thirteen public companies. This law was the first to organise the issuance of shares by companies and subscribers to these shares.⁷⁶ This was followed by the Law No. 32 in 1970 which was enacted to regulate the negotiation and transaction of company securities. At that time, there were few companies and there was a lack of sufficient knowledge about dealing in securities. This law was enacted before the Kuwait Stock Exchange was created. Law No. 32 gave the Minister of Commerce and Trade the power to issue the necessary rules to regulate the trading of securities of Kuwaiti firms. Making rules was based on the opinion of the Market Committee (MC).⁷⁷ The first market committee was established in 1976.⁷⁸ In 1977, the Kuwait Stock Exchange opened, which was the important first step along the path of trading securities in Kuwait.⁷⁹ The Stock Exchange was opened to replace unofficial unregulated stock exchanges.

⁷³ *ibid.*

⁷⁴ Ayman Abdul-hadi, *Stock Markets of the Arabic world: Trends, Problems and Prospects for Integration* (Routledge 1988) 20.

⁷⁵ Yacoub Sarkhouh, *Shares Trading in the Stock Market in Joint Stock Companies in Accordance with Kuwaiti Law* (2nd edn, Foundation Library 1993-1994) 8.

⁷⁶ Amid Salam, *Managing Crisis in the Arab and Global Stock Exchanges and Sustainable Development* (Abu Dhabi 2002) 181.

⁷⁷ The Market Committee consists of eight members. The chairman is the Minister of Commerce and Trade. It has representatives of the Ministry of Finance and the Central Bank of Kuwait. It also has five of Kuwaiti citizens with expertise and competence in financial matters.

⁷⁸ Khaled Helmy, *Legal Regulation of the Securities Market in Egyptian and Kuwaiti Law: With the Study of the Impact of the Global Financial Crisis on Arab Capital Markets* (University of Kuwait 2010) 155.

⁷⁹ *ibid* 182.

Kuwait was the first country in the region to establish a legal framework for its Stock Exchange. After the Suq al-Manakh⁸⁰ Crisis in 1983, the Kuwaiti legislature issued the Emiri Decree Organising Kuwait Stock Exchange No. 35, which sought to protect public savings and investors' interests. In 1983, the Kuwait Stock Exchange became an independent body recognised by Emiri Decree No. 20/1983. During that same year, Emiri Decree No. 35/1983 was passed. This was very important, because it included stock exchange objectives, the listing and acceptance of securities, stock exchange membership, dealing in securities, stock exchange administration, stock exchange budget and financial accounts, disputes and arbitrations, and disciplinary action. The most important change came with Article No.1, which provided that the Stock Exchange should be an independent entity.

In the 1970s individuals had a lot of liquidity available. This led to speculation on the official exchange resulting in a small crash. As a result the Kuwait government passed stricter regulation. In 1977, ministerial resolution No. 31 was issued. This aimed to prohibit the creation of new joint stock companies and the resolution worked until 1979.⁸¹ This resolution was one of the principal reasons for the Suq al-Manakh Crisis, as will be discussed later, because it drove the least risk averse investors to invest in the unofficial Suq al-Manakh market. This became a parallel market to the official market and was dominated by wealthy families whose trading was totally unregulated. Eventually, a crash occurred in 1982 which is mentioned below.

Suq al-Manakh can be described as an unofficial stock exchange market. There were 70 brokers and the market was open 24 hours a day. The process of trading relied on jobbers (market makers), who wandered around brokers' offices to order or offer shares for sale or purchase. People were prepared to pay up to 15 million dinars (approximately 50 million U.S. dollars in those days) to buy office space in the stock

⁸⁰ Selling and buying animals, such as goats and sheep, was the main function of this market.

⁸¹ Khaled Helmy (n 80) 183.

exchange to operate as brokers.⁸² During this period, compared with the official markets, the Suq al-Manakh was considered to be a third market, after the stock markets in the United States and in Japan and in advance of the markets in the UK and France. It transacted a vast number of trades.⁸³ The market became so attractive that millions of Kuwaiti Dinars were routinely transacted without even examining the credit history of the purchaser, because the people in Suq al-Manakh trusted each other. Gulf companies and many Kuwaiti public companies invested around 80% of their capital in the market, as a result of which there was a massive impact on economic growth.⁸⁴ The Suq al-Manakh⁸⁵ replaced the Suq al-Jat,⁸⁶ the previous unofficial market, which was no longer fit for buying and selling shares as a result of the volume of shares.

The Suq al-Manakh Crisis occurred between 1976 and 1982.⁸⁷ Events leading up to the crash began in 1976, when some Kuwaiti investors started to engage in establishing public companies in other Gulf countries.⁸⁸ Another interesting consideration is that the

⁸² Ali Al-Hamdan, *The Crisis of the Al-Manakh Stock Market in Kuwait* (Om Alkora Publications 1984) 39.

⁸³ <http://en.wikipedia.org/wiki/Souk_Al-Manakh_stock_market_crash> accessed 22May 2012.

⁸⁴ Jassim Al-Sadoun, *Manakh Crisis and the Crisis of the Almanakh* (Rubaiaan Company for Publishing and Distribution 1984) 150.

⁸⁵ The Suq al-Manakh was an unofficial market. It gained its name because the Bedouins located the place where camels delivered all kinds of produce in the centre of the capital.

⁸⁶ Suq Al-Jat means 'Clover Market'.

⁸⁷ It was similar to the Wall Street crash of 1929, which was the most famous crisis during the period 1921-1929. Fida Darwiche, *The Gulf Stock Exchange Crash: The Rise And Fall Of The Suq al-Manakh* (Croom Helm London 1986) 86.

⁸⁸ The Government's position on incorporating new companies and raising capital in 1976 led Kuwaiti investors to look for another country in which to set up companies. The investors entered into direct negotiations with other Emirates to create these companies. These investors exploited the absence of any legal framework in the Gulf countries. For example, before the companies started their activities, the founders of these companies that were established in Gulf countries sold their shares in spite of the Kuwaiti law that prohibited all public company founders from selling their shares in the first three years to decrease manipulation. Enormous income was gained by the investors through the unlawful situation in Kuwait.

Suq al-Manakh was allowed to trade stocks from Gulf companies, especially from the UAE and Bahrain.⁸⁹ Kuwaiti investors set up new public companies in other Gulf countries and traded with their shares because of the ban issued in that period, which halted the establishment of new Kuwaiti public companies due to the instability of stock prices, the realisation by the legislature in that period of the need to regulate the stock market, and the enormous availability of liquidity at that time. The prohibition applied only to Kuwaitis.

The crash occurred in July 1982 as a result of which some companies disappeared while the capitalisation of the others plummeted. There was no clear single reason for the crash. However, three reasons were thought to be part of the problem. The first was the absence of government involvement.⁹⁰ At that time, there was a perfect speculative atmosphere because of the lack of any legal framework and the unofficial nature of the Kuwaiti market. The second reason was the availability of risky financing tools. For example, a speculator would give a trader a post-dated cheque in payment for shares, because there was no money in the bank to cover that cheque at the time of the transaction. The speculator hoped that he would make enough profit on the shares by the time his cheque was due, and would use the shares as collateral to borrow money from the bank.⁹¹ Some companies transferred their activities to trade in markets to make an enormous profit without any real investment.⁹² The third reason is that shares from Gulf countries were not subject to any supervision by the Kuwaiti Central Bank, the Ministry of Commerce, or any other governmental or quasi-governmental entity.⁹³

Most investors in the market did not have sufficient liquidity to fulfil their obligations, because the trading was based on confidence. As noted above, some investors had

⁸⁹ S M Al Sabah, *Kuwait: Anatomy of a Crisis Economy* (Easlods 1984) 10.

⁹⁰ *ibid.*

⁹¹ Jesse Colombo, 'Kuwait's Souk Al-Manakh Stock Bubble'

<http://www.thebubblebubble.com/souk-al-manakh/> accessed 9 May 2014.

⁹² Al Sabah (n 91) 11.

⁹³ <http://www.gulfta.com/forum/archive/index.php?t-4209.html> accessed 22 May 2012.

bought and sold securities by using post-dated cheques. This practice inflated securities' prices. The majority of traders were in possession of post-dated cheques.⁹⁴ The crisis began to surface when one of the major traders could not cash in his post-dated cheques and then tried to resolve this by asking his debtors to pay their debts. His debtors in turn went to their debtors to cover their positions. This situation prompted the traders involved to cash their post-dated cheques hurriedly, even before the cheques had matured. Approximately 89 billion US dollars were introduced into the market. However, there was not enough money to cover the total amount of post-dated cheques collected. As a result, future deals were based on the shares traded in the market.⁹⁵ In fact, the Suq al-Manakh was based on the hope of continuously increasing security prices and on the use of post-dated cheques.⁹⁶

Even after the crash ended its effects remained for a long time. For example, eight people known as the 'Knights al-Manakh' owed around \$100 billion, which amounted to approximately 70% of all debts. This meant that those people owed approximately four times the Kuwait national budget, which at that time was around \$18 billion.⁹⁷ Not only did the crisis impact traders and ordinary people, but also some MPs and even the Royal Family, ministers and others, so the crisis affected all members of the community.⁹⁸ As a consequence of the crash, the Kuwaiti market lost its reputation, and many foreign banks were unwilling to trade with Kuwaiti companies. In addition, the Kuwaiti government spent approximately \$3 billion to help small investors⁹⁹ because individual investors had become involved without protection from the law.

⁹⁴ Al Sabah (n 91) 11.

⁹⁵ Jesse Colombo (n 93).

⁹⁶ 'The Middle East and North Africa 2004' *Regional Surveys of the World* (Europa publications 2004) 692.

⁹⁷ <<http://www.youtube.com/watch?v=oNN2PpACmWk>> accessed 15 April 2014.

⁹⁸ The Al-Watan newspaper wrote at the time: 'Some say the market crashed, because the ministers spent their time hunting bargains on the stock market leading to deals and that they took advantage of their public office to realise private gains.' Fida Dawiche (n 89) 92.

⁹⁹ Alsabah (n 91) 17.

The collapse of the Suq al-Manakh took place in August 1982, which marked the beginning of the end of the unregulated market. The government made a mistake when it refused to intervene, because it firmly believed that the perfect market is a free market. The government did not pass any regulations to control the market.¹⁰⁰ Vested interests of powerful wealthy families prevented the government from taking action to regulate this exchange and this was the major reason why the crash occurred.

The Suq al-Manakh crisis made the government realise that there was a need for the regulation of activities involving securities. Between 1983 and 2010, a number of laws were passed to regulate the stock exchange. In 1988, Decree Law No. 32 granted permission to GCC citizens to hold (own) shares in the Kuwaiti public companies listed on the Kuwaiti Stock Exchange. Previously, GCC citizens were not permitted to buy shares in Kuwaiti companies. In 1990, the Kuwaiti legislature created a legal system for unit trusts in Act No. 31, which involved organising the trading of securities and the establishment of investment funds. In 2000, Law No. 20 was enacted to allow non-Kuwaiti investors to own shares in Kuwaiti shareholding companies, because the legislature believed in attracting foreign investors in order to take advantage of their money and expertise.¹⁰¹

In 2000, the Stock Exchange market capitalisation was US \$35 billion, and the value of trading was US \$22 billion, making the Kuwaiti Stock Exchange the second largest in the Arab world.¹⁰² This prompted the government to make changes to the operation of the Stock Exchange. In 2005, Emiri Decree No. 158 was issued concerning the amendment of some articles of the decree organising the Kuwaiti Stock Exchange.¹⁰³

¹⁰⁰ *ibid* 6-7.

¹⁰¹ Explanatory note of Law No. 20 of 2000.

¹⁰² ‘Financial Sector Assessment Program (Kuwait 2004) Detailed Assessments of Observance of Standards and Codes-International Organisation of Securities Commission (IOSCO) - Objectives and Principles of Securities Regulation’ (International Monetary Fund, the World Bank) 5.

¹⁰³ Some of the amendments of Article 3 provide that:

The KSE holds the responsibility of organising and supervising the financial market emphasising the following: 1 - Organising and protecting trading securities. 2 -

Before 2010, the Ministry of Commerce and Trade (MOCI), the Central Bank of Kuwait (CBK),¹⁰⁴ the Market Committee (MC) and the Kuwait Stock Exchange (KSE) were responsible for regulating and supervising securities markets in Kuwait.¹⁰⁵ The absence of a comprehensive law involved in creating and organising the Kuwait Stock Exchange and the lack of a single body with responsibility for regulation resulted in some deficiencies that were exploited by unscrupulous dealers at the expense of small and large investors. There was no comprehensive and holistic legal system, the lack of

Organising the announcement of interests and issuing and declaring the financial reports. 3 - Specifying the methods of dealing with securities ensuring the soundness of information and protecting the traders. 4 - Developing the financial market to serve the goals of economic development. 5 - Developing the market links with other regional and global markets to keep pace with the standards followed in those markets.

Article 6 mentions that:

The market committee is responsible for setting the general rules and policies for KSE within the goals mentioned in Article 3 of this decree, especially in setting the following rules and procedures:

1 - Dealing with securities, supervising its activities. 2 - Central depository, settlement and clearing, and supervising its activities. 3 - Registration of brokers and the stocks of the listed companies. 4 - Supervising the dealing of funds and investment portfolios with securities listed in the market. 5 - Preparing, disclosing and supervising the financial reports of the listed companies and investment funds. 6 - Regulations for acquiring effective percentage of the company's capital. 7 - Regulations for banning trading based on internal or unannounced information or conflict of interest. 8 - Regulations regarding professional conduct and confidentiality of the market's employees and the companies dealing with securities. 9 - Preparing reports and analyses as well as stating the regulations that should be abided by in preparing the above. 10 - Procedures to be taken by the market administration under exceptional circumstances, including the decision to suspend one or more companies from trading their stocks in the market for a period determined by the market administration. 11 - Approval of the market projected annual budget, probating the final accounts, and assigning a financial auditor.

¹⁰⁴ The Collective Investment Scheme (CISs) was supervised by the CBK.

¹⁰⁵ (n 104) 4.

which created misunderstanding and the inability to resolve serious systemic problems.¹⁰⁶ In 2010, the Act was enacted to address these problems.

The 2010 Act was supposed to fix all previous problems relating to securities activities firstly by having for the first time a regulatory authority that was responsible for regulating securities activities. Secondly a number of illegal activities related to securities were banned for the first time under the 2010 Act such as insider dealing, manipulation and misleading the market.

The Act has 13 chapters and 165 articles. The first chapter is about the definitions of words and terms wherever they are used in the Act such as exchange, clearing agency, a security, listed company and others. The second chapter (from article 2 to article 30) is about the Capital Market Authority and its objectives, duties, powers, managing the authority board. For example, Article 3 of chapter 2 mentions the objectives of the Kuwaiti Authority which are:

- 1- Regulate securities activities in a fair, transparent and efficient manner.
- 2- Grow the capital markets, and diversify and develop investment instruments thereof in accordance with best international practice.
- 3- Enhance investors' protection.
- 4- Reduce systemic risks arising from securities activities.
- 5- Impose requirements of full disclosure in order to achieve fairness and transparency, and to prevent conflicts of interests and the use of insider information.
- 6- Enhance compliance with the rules and regulations related to securities activities.
- 7- Enhance public awareness of securities activities and of the benefits, risks and obligations arising from investments in securities and encourage their development.

¹⁰⁶ Khaled Helmy (n 80) 170.

The Act has seven aims. One of these objectives is protecting investors which are the subject of the thesis. The Act mentions the aims but it does not mention the way of achieving them and nor does it explain them. The Act also gives the authority the power to pass rules according to Article 4 by saying that ‘the Authority’s board shall issue necessary byelaws and instruments to execute the Law. It shall also work on issuing recommendations and the necessary studies needed to develop the regulations which assist in achieving its objectives’.

Chapter three (articles 31-47) of the Act is about securities exchanges. Chapter four (articles 48-62) is about clearing agency. Chapter five (articles 63-67) is about regulated securities activities. Chapter six (articles 68-70) is about reviewing the accounts of licensed persons. Chapter seven (articles 71-75) is about acquisitions and protection of minority interests. Chapter eight (articles 76-91 articles) is about collective investment schemes. Chapter nine (articles 92-99 a) is about the prospectus for securities issued by companies. Chapter ten (articles 100-107) is about disclosure of interests. Chapter eleven (articles 108-148) is about penalties and disciplinary actions. Chapter twelve (articles 149-150) is about general rules. Chapter thirteen (articles 151-165) is about transitional provisions. The act covers transactions and other dealings with securities. The Act also was the first major legislation to regulate the offer and sale of securities.

1.7.2 Saudi Arabia

The Saudi Stock Market is one of the largest markets in the Gulf region. For example, the market in 2003 stood at US \$157 billion. The number at the end of 2014 was around \$ 483 billion.¹⁰⁷ However, the Saudi market was informal until the mid-1980s. Consequently, it does not have a long history. In 1995, only 33 companies were listed on the Stock Exchange; by 2005 that number had increased to 77 companies.¹⁰⁸

¹⁰⁷ <http://www.tadawul.com.sa/static/pages/ar/Publication/PDF/Yearly_2014.pdf> accessed 14 June 2015.

¹⁰⁸ Monzurul Hoque, ‘Saudi stock exchange market crash was predictable’ Paper presented to the Conference of Securities Markets and Stock Exchanges, United Arab Emirates University-College of Sharia and Law 2006) 1.

Nowadays, there are 151 companies on the Saudi Stock Exchange.¹⁰⁹ In 2015 the number is 164 companies.¹¹⁰ The first public company was established in Saudi Arabia in 1934. In 1983, there were approximately 38 public companies.¹¹¹

In 2001, a new infrastructure was introduced that is known as the Tadawal or Stock Exchange. This resulted in a rapid increase in transactions per day. Before that, trading took place through local banks. A more important structural change has been the establishment of the Saudi market in 2003 when the Capital Market Act was passed.¹¹² A significant event in the Saudi Stock Exchange occurred between 2002 and 2006. During this period, there was a large increase that can be described as a bubble in the Saudi Market Index (TASI), which rocketed by approximately 563%. Whether this dramatic increase was the result of real structural economic factors or it was just irrational is unknown.¹¹³ After that period, a huge drop occurred which cost many investors their money and their savings because the share values plummeted and stayed low for a long period. The rise was just a false increase, which cost many people their investments. Some experts said that the most important reason for this false increase was that the Saudi market lacked laws and regulations to govern the stock exchange. This was clear when the index dropped from 21,000 points in the middle of February 2006 to approximately 9,500 points just two months later without any change in economic factors.¹¹⁴

¹⁰⁹ <<http://www.tadawul.com.sa/wps/portal/>> Official website of the Saudi Stock Exchange market. accessed 22 May 2012.

¹¹⁰ <http://www.tadawul.com.sa/wps/portal!/ut/p/c1/04_SB8K8xLLM9MSSzPy8xBz9CP0os3g_A-ewIE8TIwODYFMDA08Tn7AQZx93YwMDA_3gxCL9gmxHRQDFabfS/> accessed 14 June 2015

¹¹¹ Essam Albahja, *Legal Encyclopaedia for the Stock Exchange in the Arab Legislations* (dar el gamaa el jadida 2009) 97.

¹¹² *ibid.*

¹¹³ Ahmed Badawi, 'Empirical Evidence of Herding Behaviour in the Saudi Stock Exchange Market' (Paper presented to the Conference of Securities Markets and Stock Exchanges, United Arab Emirates University-College of Sharia and Law 2006) 1.

¹¹⁴ Hamdi Abu-Zeid, *Stock market crisis: The warning call for reform* (2006) 136.

1.7.3 Qatar

The Qatar Stock Exchange also does not have a long history. It was founded in 1995 (previously Doha Securities) under Law No. 14.¹¹⁵ On September 14 2005, Act No. 33 of 2005 as amended by Legislative Decree No. 14 of 2007 established the Qatar Financial Markets and the Doha Securities Market. Under this law, the Qatar Financial Markets Authority (QFMA) holds the legislative and regulatory framework, while the executive role is held by the Qatar Exchange with respect to trading shares, the transfer of ownership, and making financial settlements between brokers.¹¹⁶

The Qatar market entered a new phase in 2009 with the issuing of an amendment to Law No. 33, which transferred the Doha Securities Market to a joint stock company under the name of the Qatar Exchange. This transfer was intended to bring about a shift in the structure that would help with the transition to a global exchange and to operate according to the latest systems.¹¹⁷ The market opened with 17 companies, and has since increased to 45 companies.¹¹⁸ On August 7 2012, Qatar passed a new Law No. 8 of 2012 regarding the Qatar Financial Markets Authority, which repealed the law of 2005 and subsequent amendments.¹¹⁹

The following table (Table 1.3) shows the significant market indicators in 2012 for the Kuwait, Saudi and Qatar stock exchanges.

¹¹⁵ *ibid* 112.

¹¹⁶ <<http://www.mofa.gov.qa/details.cfm?id=216>> accessed 20 May 2012.

¹¹⁷ *ibid*.

¹¹⁸ Official website of Qatar Exchange

Market<<http://www.qe.com.qa/pps/qe/qe%20english%20portal/Pages/Home//>> accessed 23 May 2015.

¹¹⁹ The amount of information reflects the size of the stock exchange which is smaller than Kuwait and Saudi. Moreover Qatar Stock exchange has not experienced as many notable events during its evolution.

Country	Number of listed companies	Trading Value (Mil. \$)	Volume of Traded Shares (Mil. Share)	Market Capitalisation of the companies whose shares are listed (Mil. \$)
Kuwait ¹²⁰	216	23 812.5	82 805.5	130 677.1
Saudi ¹²¹	148	501 417.2	83 653.0	373 404.6
Qatar ¹²²	42	17 719.4	2 190.2	103 929.9

Table 1.3 Stock Market Indicators

As a result, it is clear that legal developments differ from one country to another. In connection with this thesis Qatar, Saudi and Kuwait have a special law for securities, which is the material of this thesis.

1.8 The historical development of the legal systems in Kuwait, Saudi and Qatar

A multifaceted interplay of economic, social, and political factors has affected the current legal systems in the Arabian Gulf countries comprising Kuwait, Saudi Arabia, Qatar, Bahrain, Oman, and the United Arab Emirates. This region is commonly referred to as the GCC. The rural places along the Arabian Peninsula were rooted mainly in

¹²⁰ Annual Report 2012 of Kuwait Stock Exchange.

<<http://www.kuwaitse.com/Portal/Report/KSEAnnual2012.pdf>> accessed 6 May 2014.

¹²¹ Annual Report 2012 of Saudi Capital Market Authority.

<<http://www.cma.org.sa/Ar/Publicationsreports/DocLib/Report%20CMA%202012%20Final2.pdf>> accessed 6 May 2014.

¹²² Annual Report 2012 of Qatar Exchange.

<<http://www.qe.com.qa/pps/qe/qe+english+portal/Pages/About+QE/Annual+Report?>> accessed 5 May 2014.

tribal custom, and tribal elders performed adjudicative functions.¹²³ The Quran, the Sunnah (the prophet's traditions), the Ijma (consensus of Muslim jurists), and the Qiyas (judgment upon juristic analogy) were the main sources of Shari'ah Islamic law, which was widespread in the region and was the source of authority in the entire area. Islamic law is sacred. It has four main sources: the Quran,¹²⁴ the Sunna,¹²⁵ the Ijma,¹²⁶ and the Kiyas.^{127,128}

The largest economic event in the history of the GCC States was the discovery of oil and natural gas in the region. Previously, the main economic activities were agriculture, fishing, trade and pearl-diving¹²⁹ in addition to camel and sheep herding. The discovery of oil created a new economic, social and political order which could no longer rely solely on customs and Shari'ah Islamic law. All the GCC countries except Saudi Arabia decided to adopt the Egyptian-French model¹³⁰ as a basis for their national legal systems. However, these legal systems have been influenced by Islamic law. For example, the Kuwaiti civil code is influenced by Islamic law.

Kuwait was first mentioned in history as a country in the eighteenth century, when the Sabah family came to Kuwait in approximately 1765. In 1899, the modern Kuwait appeared with the signing of a protection agreement with the British. Sheikh Mubarak (the ruler of Kuwait) signed an agreement, because he feared an external attack from the Ottoman Empire. The British were also concerned about the extension of Russian and

¹²³ Ahmed Al-Suwaidi, *Finance of International Trade in the Gulf* (Graham & Trotman 1994) 24.

¹²⁴ Book of God.

¹²⁵ The prophet Muhammad life and times between 610 and 632 CE, transmitted from generation to generation; Frank E Vogel, *Islamic Law and Legal System Studies of Saudi Arabic: Studies In Islamic Law and Society* (Brill 2004) 4.

¹²⁶ Consensus of researchers.

¹²⁷ Reasoning by parallel.

¹²⁸ Joseph Schacht, *An Introduction to Islamic Law* (OUP 1964) 114.

¹²⁹ Ahmed Al-Suwaidi (n125) 9.

¹³⁰ The French legal system spread into some Arab countries through Egypt.

German interests in the area. According to the agreement, Kuwait promised that it would not receive an agent or representative of any other power or government in Kuwait without a previous sanction by the British government.¹³¹ During this period, Kuwait relied on Islamic law and custom; there was no written law. However, the judges were separate from the ruling family,¹³² who were the head of the executive authority; the judges were the head of the judiciary.¹³³

In the twentieth century, the Islamic countries converted from Islamic law to modern law.¹³⁴ In 1938, judges had to follow a civil code known as the ‘Mejelle’, which was written by the Ottoman Empire between the nineteenth and the twentieth centuries. It consists of collections of a civil code of Islamic law, containing 1,851 Articles based on the Hanafi Islamic School.¹³⁵ In the same year, the first council was elected to represent the people. The next important event in Kuwaiti history occurred in 1961, when Kuwait withdrew from the British extra-territorial jurisdiction and the Constitution of Kuwait was drawn up. In 1963, Kuwait became a member of the United Nations (UN).

The Kuwaiti people are the source of all power and the democratic system of government. Article 6 of the Kuwaiti Constitution provides that the system of government in Kuwait shall be democratic and that sovereignty resides in the people, the source of all power but in practice the legislative power¹³⁶ is with the Emir and the National Assembly, which consists of 64 democratically elected members.¹³⁷ The Emir

¹³¹ Osman Abd-Malik, *Constitutional Order and Political Institution In Kuwait* (Dar Al-Kotob 2003) 53-55.

¹³² The ruling family is Al Sabah.

¹³³ Khalid Toama, *The History of Kuwait Law* (2008) 14.

¹³⁴ Joseph Schacht (n130) 3.

¹³⁵ <<http://en.wikipedia.org/wiki/Mecelle>> accessed 24 April 2014.

¹³⁶ Article 51 of the Kuwaiti Constitution says that the legislative power is vested in the Emir and the National Assembly.

¹³⁷ Kuwaiti Constitution, Article 56 provides that the number of Ministers in all shall not exceed one-third of the number of the members of the National Assembly.

is the Head of State.¹³⁸ In addition, the Council of Ministers has executive power.¹³⁹ There are no political parties in Kuwait. The Emir appoints the Prime Minister, who then chooses the Council of Ministers.

The legislative, executive and judiciary are the three authorities in Kuwait. There are clear distinctions among these three branches. Article 50 of the Kuwaiti constitution says that the system of Government is based on the principle of separation of powers functioning in co-operation with each other in accordance with the provisions of the Constitution. None of these powers may relinquish all or part of its competence specified in the Constitution. The Kuwaiti judicial system¹⁴⁰ is comprised of three stages of adjudication. All courts in Kuwait pass sentences in the name of the Emir. Article 53 of the Kuwaiti Constitution says that the judicial power is vested in the courts, which exercise it in the name of the Emir within the limits of the Constitution.

Around 1960, a new legal system appeared to replace Shari'ah law. Article 2 of the Kuwaiti Constitution provides that 'the religion of the state is Islam and Islamic Shari'ah is a principal source for legislation'.¹⁴¹ This means that Shari'ah is not the exclusive source of Kuwaiti law, it also includes many codes, such as civil, commercial, company and criminal codes. However, the relationship with Shari'ah remains. For example, in civil cases, if a situation is not included in the code, the judge must look to Shari'ah law.¹⁴²

¹³⁸ Kuwaiti Constitution, Article 54 (the Emir is the Head of the State. His person is immune and inviolable). Article 55 (the Emir exercises his powers through his Ministers).

¹³⁹ Article 52 of the Kuwaiti Constitution says that the executive power is vested in the Emir, the Cabinet, and the Ministers, in the manner specified by the Constitution.

¹⁴⁰ In Kuwait, there are different levels of courts, namely summary, first instance, appeals and cassation courts. The latter considers solely the law without looking at the facts.

¹⁴¹ Ahmed Al-Suwaidi (n 125) 25.

¹⁴² Article 1 Kuwaiti Civil Law, amended in 1996.

The Shari'ah is the main source for legislation as provided in Article 2 of the Kuwaiti Constitution. This is the subject of much discussion in Kuwaiti society, because many want to make Shari'ah the only source of law. At present, there are other sources of law which can contradict Shari'ah, a clear example is commercial law, which allows for the payment of interest or Riba.¹⁴³

The Kuwaiti legal system is similar to the Egyptian and French codes, which are known as the 'Latin System'.¹⁴⁴ In 1804, the Napoleonic code was widespread in western and southern Europe and Latin America.¹⁴⁵ Samiha Qalyoobi criticised the slow pace of the development of laws in Kuwait and gave an example of the Kuwaiti Company Law, which was adopted from the French Company Law in 1960. French Company Law has changed eight times in the intervening period; Kuwait's Company Law was not changed until 2012.¹⁴⁶

In Saudi Arabia the constitution is unwritten and is very unclear,¹⁴⁷ in contrast to the constitutions of the other Gulf countries, which are written. In Saudi, Shari'ah law can be supplemented by the King, who can issue royal decrees to achieve a satisfactory balance between present day socio-economic requirements and Islamic traditions. As a result, business law in general and laws dealing with investments and overseas trade in

¹⁴³ Article 102 of the Commercial Code provides: (1) The creditor has the right to interest in a commercial loan unless the contrary is agreed; if the rate of interest is not specified in the contract, the interest due shall be the legal interest of seven per cent. (2) If the contract contains agreement on the rate of interest and the debtor delays in payment, then interest for delay shall be calculated on the basis of the agreed rate. However, Article 547 of the Civil Code provides: (1) Loans shall be without interest. Any condition to the contrary shall be void, without prejudice to the loan agreement itself. (2) Any benefit stipulated by the lender shall be considered interest.

¹⁴⁴ <<http://www.al-ayoub.org/legal.html>> accessed 24 April 2014.

¹⁴⁵ Raymond Wacks, *Law: A very short introduction* (OUP 2008) 8.

¹⁴⁶ Samiha Qalyoobi, 'A lecture on Kuwaiti. First Conference to Discuss the Most Important Development in the New Companies Act: The Provisions Related to adjusting the conditions of existing companies' (Office of Loay Jassim Al-Krafi Law Firm 2014).

¹⁴⁷ Ahmed Al-Suwaidi (n 125) 26.

particular have grown greatly in terms of legal decrees that codify these subjects. This development occurred as the result of increased development in Saudi Arabia and to avoid legal problems. For example, the Company Law was issued in 1965 and amended in 1978 by royal decrees.¹⁴⁸

In Saudi, Shari'ah is the main source of legislation and in cases where the Shari'ah does not cover all aspects of laws such as traffic law, the King passes the law on condition that the new law is not against Shari'ah. This makes the legal system in Saudi different from the rest of the regimes in the region. In Saudi, there is no distinction between legislative and executive authorities. Both are controlled by the King. The King in Saudi has unlimited power. He is the head of state and the head of council of ministers.¹⁴⁹

Qatar has had three constitutions. The first was ratified on 2 April 1970, but was replaced two years later by an amended provisional constitution. Article 7 of the 1970 constitution provided that the religion of the state is Islam and that Islamic Shari'ah is the principal source for its legislation. Qatari Law No.16/71 was passed in 1971 and amended by Law No. 10/82 in 1982, which enacted civil and commercial laws.¹⁵⁰ The third and current Qatar constitution has 150 articles and was ratified in 2004. It repealed the 1972 constitution. It is clearer than the two previous constitutions. It came with new ideas, such as the fact that Qatar is a hereditary Emirate that is ruled by the Al Thani family.¹⁵¹ It mentions that Shari'ah law is one of the main sources of legislation.¹⁵² This means that it is not the only source. The constitution mentions a number of principles. For example, article 18 states that 'the Qatari society is based on the values of justice,

¹⁴⁸ *ibid.*

¹⁴⁹ <http://www.nyulawglobal.org/globalex/saudi_arabia.htm> accessed 20 December 2014.

¹⁵⁰ Ahmed Al-Suwaidi (n 125) 26.

¹⁵¹ Article 8 states: 'The rule of the State is hereditary in the family of Al Thani and in the line of the male descendants of Hamad Bin Khalifa Bin hamad Bin Abdullah Bin Jassim'.

¹⁵² Article 1 states: 'Qatar is an independent sovereign Arab State. Its religion is Islam, and Shari'ah law shall be a main source of its legislation. Its political system is democratic. The Arabic Language shall be its official language. The people of Qatar are a part of the Arab nation'.

benevolence, freedom, equality, and high morals'. Articles 34¹⁵³ and 35¹⁵⁴ mention the public's rights and duties. The current constitution provides two ways to propose new legislation. One is by the Shoura Council; the other is through the Cabinet of Ministers. However, the final draft must be approved by the Emir.¹⁵⁵

1.9 Conclusion

This chapter discussed the aims and the benefits of the thesis and the methodology that the thesis will follow. The research will explore ways in which investors on the Kuwait Stock Exchange can be better protected against market abuse, irresponsible actions and poor corporate governance risks. This aim will be achieved by comparing the Kuwaiti 2010 Act with legislation in the GCC countries and, when necessary, with legislation enacted in some of the developed countries, such as the UK and the USA. The structure and the difficulties of the thesis have also been discussed. This research has faced three difficulties namely, a poor understanding of securities laws, poorly documented financial regulation in the GCC and the rapidly changing financial regulation during the course of this research.

This chapter has outlined the extent of the research in this thesis. In terms of financial markets, this research will focus on secondary stock exchange markets and in respect of financial products, it will look at the direct trading of shares in listed companies. In terms of investors, individual investors are the focus of this research. In terms of laws and regulations, it will focus on securities law and with regard to risk will discuss methods of protection against direct risks related to insider dealing as an example of market abuse, unfair disclosure and poor corporate governance.

¹⁵³ Article 34 states: 'The Citizens of Qatar shall be equal in public rights and duties'.

¹⁵⁴ Article 35 states: 'All persons are equal before the law, and there shall be no discrimination whatsoever on grounds of sex, race, language, or religion'.

¹⁵⁵ <<http://www.qatarlaw.com/legislation-legal-system-in-qatar>> accessed 21 December 2014.

This chapter has discussed the historical developments of the stock exchanges and their legal frameworks in Kuwait, Qatar and Saudi Arabia. These countries lack a long history and experience with regard to the regulation of a stock exchange. After the Suq al-Manakh crisis, the Kuwaiti government recognised the need to regulate the stock market. It passed several laws to regulate the market, the latest of which was in 2010. The 2010 Act is a comprehensive law and created a single body (Kuwait Capital Market Authority) with the responsibility to regulate the market.

Before the discovery of oil, the GCC countries relied mainly on Shari'ah Islamic law. Thereafter, these countries tried to find a legal system that combined Shari'ah law and the Egyptian French model. Although Qatar, Saudi and Kuwait have different legal systems related to the material of this thesis, each has a special law for securities.

The next chapter will deal with the protection of individual investors under securities law.

Chapter Two

The Concept of Protecting Investors under Securities Law

2.1 Introduction

This chapter aims to provide more detail about the aims and objectives of the thesis and to serve as a general background to the world of investor protection.

The concept of protecting investors under securities law has four elements: the investors, the securities, the securities law and the meaning of protecting investors. Each of these elements has many ramifications. Before looking at the subject of this thesis, an introduction to each of the elements will help to understand the thesis.

As mentioned in Chapter One, in this thesis investors are ordinary persons who try to ensure a good future for themselves and their families by improving their standard of living, obtaining a good education for their children and protecting the value of their savings. This type of investor differs from others in terms of the type of protection that is required.

To understand how securities law works one needs to appreciate what is meant by the term securities and that shares are only one type. Some countries regulate their financial systems with laws targeted at securities to complement other laws, such as company law and commercial law. Other laws can play a significant role in protecting investors and they will be mentioned later but will not be considered in detail in this thesis. This thesis will discuss the areas of protection and how to achieve such protection. However, there is no perfect way to protect investors on the stock exchange. This chapter will focus on four points. The first concerns investors. The second defines securities. The third defines securities law and the fourth is about the scope of the protection.

In addition to clarifying the position of an investor in the financial markets, this chapter also mentions for the sake of completeness some non- securities specific legislation which contributes to investor protection but is too extensive to analyse in detail in the thesis.

2.2 Who Are Investors?

An owner of money can be a spender, saver or investor. Investors are generally people or companies who want to increase their wealth. They can do so by investing their money in a number of places, such as 1) deposit money in a bank without risk,¹ although the interest rate is generally poor compared to other investments; 2) buy real estate; 3) buy bonds that are issued by companies or by a government, receiving a fixed income on a fixed date in the future; 4) buy vintage cars or antiques; or 5) buy shares in a company, which is more flexible, with potentially higher returns than a bank deposit, but presents a higher risk. This thesis will focus on investors who buy shares in a company which are traded on a stock exchange. Investors in the stock exchange are different from speculators² in terms of the period of investment, degree of risk and expected return. The latter trades are based on short term price fluctuations³ and are carried out by people who are experts in taking advantage of such fluctuations.⁴

¹ For example, in the UK deposits with authorised financial services firms are insured with the FCSC to the extent of £85,000. < <http://www.fscs.org.uk/what-we-cover/eligibility-rules/compensation-limits/>> accessed 2 February 2015.

² Speculators, who are also known as dealers, are one of the participants in financial markets, in addition to investors and brokers. The main motive of speculators is to realise profit by buying and selling shares over a short period and not from owning shares for a long period. Jakob de Haan, Sander Oosterloo and Dirk Schoemaker, *Financial Markets and Institutions: A European Perspective* (2nd edn, Cambridge University Press 2012) 31.

³ Jihan Jamal, *Methods and Strategies for Speculation in the Stock Exchange* (Economic Publishing & Distribution 2012) 22.

⁴ Mohamed Helmy Abdel Tawab, *The Legality and Technical Frames For The Stock Exchange and Mechanisms of the Legality Observation* (Dar Al Fikr Al Arabi 2012) 395.

Individual investors usually want to increase personal wealth. Individuals can invest by holding collective funds, allowing others to handle the investment process or by buying shares in individual companies. In addition to individual investors, there are institutional investors. Both individual and institutional investors can be majority or minority shareholders and can be local or foreign investors. Institutional investors include pension funds, mutual funds and insurance companies; these have increased significantly over the years.⁵ Individual investors are persons not businesses.⁶ This thesis will focus on protecting individual investors regardless of their nationality and their minority or majority status. The protection of institutional investors is beyond of the scope of this thesis.⁷ Figure 2.1 shows types of investor on the stock market.

⁵ Mats Isaksson and Serdar Çelik, 'Who Cares? Corporate Governance In Today's Equity Markets' (OECD Corporate Governance Working Papers No. 8 2013) 33 < http://www.oecd-ilibrary.org/governance/who-cares-corporate-governance-in-today-s-equity-markets_5k47zw5kdnmp-en ≥ accessed 9 September 2013.

⁶ In the UK, the Consumer Protection from Unfair Trading Regulations 2008 s2(1) defines a consumer as 'any individual who in relation to a commercial practice is acting for purposes which are outside his business'.

⁷ In the financial literature, it is always small investors who are the victim. Also institutional investors do not need as much protection as individuals investors.

Stock Market Investors

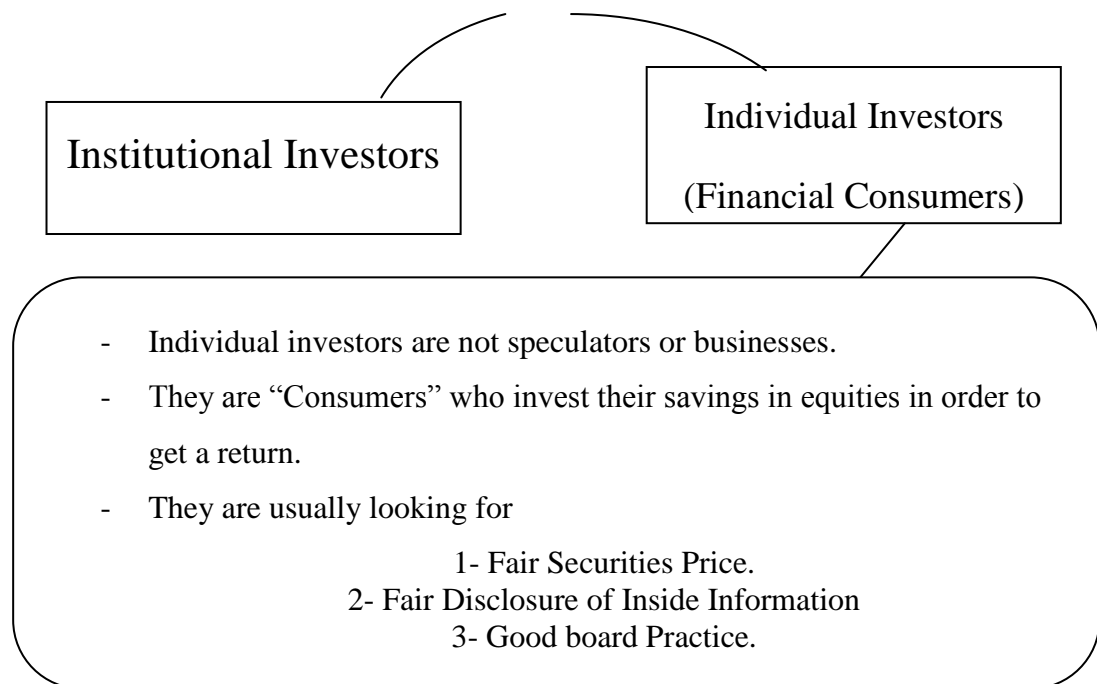


Figure 2.1: Stylised diagram of investor types in stock market.

One of the aims of the regulation of financial services in the UK is to protect individual investors (consumers of financial services). The Financial Services Act 2012 defines consumers⁸ to include two types of persons: 1) persons who use, have used, or may use financial services or who have relevant rights or interests in relation to those services. Financial services could be regulated financial services⁹ or services that are provided by persons other than authorised persons who are carrying on regulated activities. 2) Persons who have invested or may invest in financial instruments or who have relevant

⁸ Financial Services Act 2012 part 1A s1G.

⁹ Financial Services Act 2012 part 1A, section 1H, 2 states that regulated financial services are ‘services provided a) by authorised persons in carrying on regulated activities; b) by authorised persons in carrying on a consumer credit business in connection with the accepting of deposits; c) by authorised persons in communicating or approving the communication by others, invitations to engage investment activity; d) by authorised persons who are investment firms, or credit institutions, in providing relevant ancillary services; e) by persons acting as appointed representatives; f) by payment services providers in providing payment services; g) by electronic money issuers in issuing electronic money; h) by sponsors of issuers of securities; and i) by primary information providers to persons who issue financial instruments’.

rights or interests in relation to those instruments. This thesis will only focus on the latter.

In Kuwait, the securities law does not distinguish between individual and institutional investors, nor does it distinguish between individual investors who use financial services and those who invest in financial instruments. This will be discussed in detail in Chapter Six.

The financial system has many players. On the one hand, there are banks, shadow banks, suppliers of financial products and services, and other companies. On the other hand, there are the consumers of financial products and services (including investors). In addition, there are different markets that make up the financial system namely the FOREX Market, Derivatives Markets, Money Markets and the Capital Market. The Stock Exchange is one of the capital markets. The Stock Exchange has two markets: Primary and Secondary (where shares trade every day). As far as markets are concerned this thesis will only look at the secondary market, while as far as players are concerned this thesis will look at investors. Therefore, this thesis will focus on protecting investors in secondary markets. The figure 2.2 below shows the parts of the financial system.

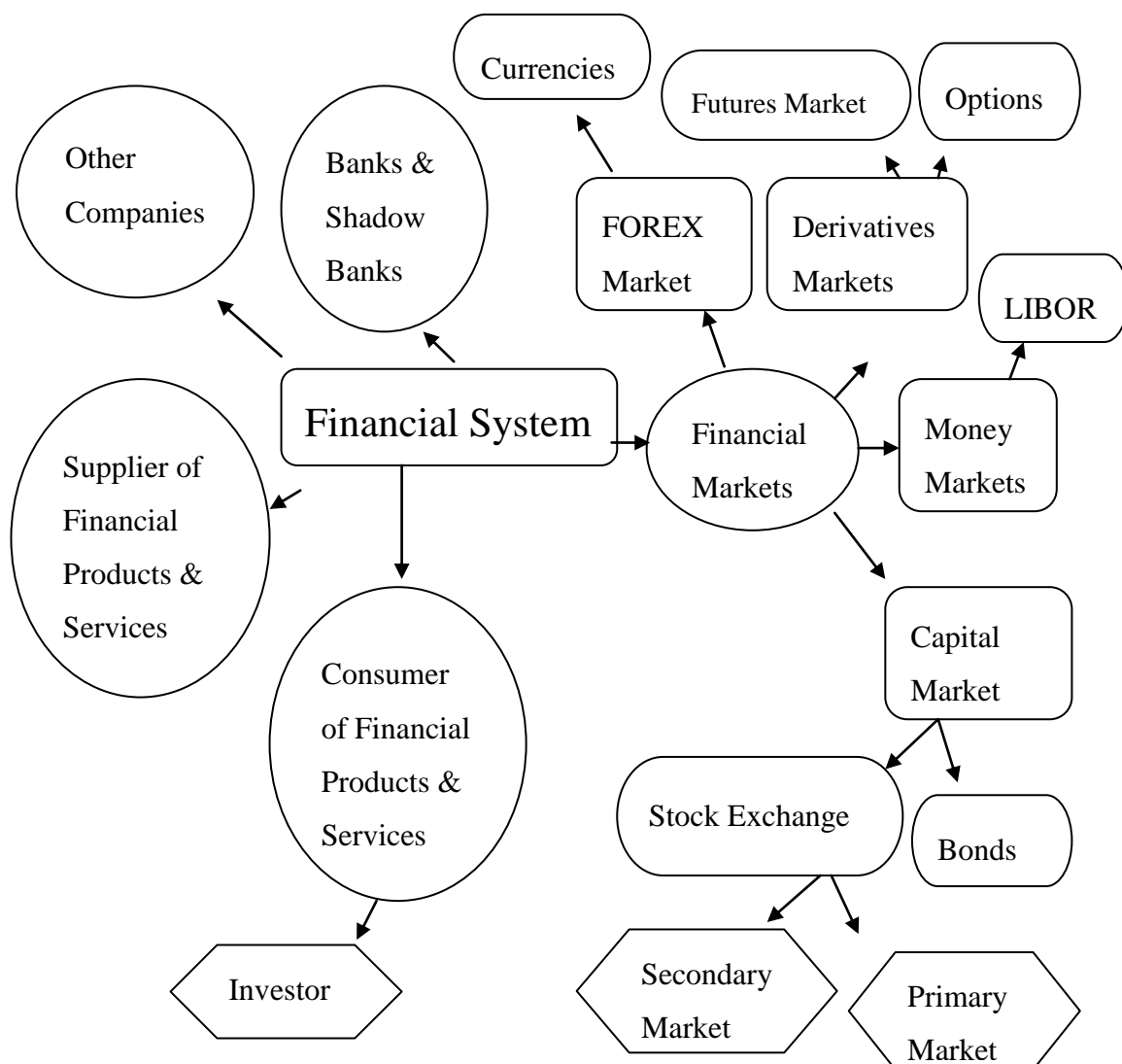


Figure 2.2 Stylised diagram of the parts of the Financial System.

Sophisticated investors are investors with real experience and understanding of the risk involved.¹⁰ They can be defined as persons who know what legal protection they have and are fully capable of protecting themselves from securities fraud. Lynn Stout criticises this idea by saying that history has shown that no one can be sure that he will not be defrauded and if you ask any investor who lost his money whether he expected

¹⁰<<http://www.investopedia.com/articles/investing/042613/how-become-sophisticated-investor.asp>>
accessed 7 October 2015

to be defrauded, the answer would be no. Individual investors cannot make a distinction between honest, good and well run companies from poorly managed and dishonest firms. They need regulation to protect them. They need some compulsory protection.¹¹ The majority of retail investors are not sophisticated.¹² Protection in this thesis will include sophisticated and less sophisticated investors.

In the financial literature, the idea is about offering some types financial instruments to people who are aware of their decisions and the law should stop unsophisticated investors from being a danger to themselves and others.¹³ For example, in the UK, some type of financial instruments such as unregulated collective schemes (Ucis) which are based on some kind of investment such as film protection are promoted to sophisticated investors.¹⁴ These financial instruments can be described as dodgy alternative products. Also in the UK also in 2014, the FCA restricted the promotion of contingent securities just to sophisticated or high net worth investors.¹⁵

Gaetane willemaers said that from an economic point, prohibiting retail investors from direct access to the capital markets (stock exchange) is not a good solution because retail investors increase the liquidity in the market which contributes to the strength of stock exchange markets and to economic stability too.¹⁶

Discussing sophisticated or unsophisticated investors is out the scope of the thesis because the thesis will not look at these types of financial products such as Ucis. It will just focus on shares which anyone can buy. The thesis is also about investors in shares and not other more risky instruments where the level of sophistication is important.

¹¹ Gaetane Schaecken Willemaers, *The EU Issuer Disclosure Regime: Objective and Proposals for Reform* (Kluwer Law International 2011) 11

¹² *Ibid* 34

¹³ <http://papers.ssrn.com/sol3/papers.cfm?abstract_id=322301> accessed 14/11/2015

¹⁴ <<http://www.moneyobserver.com/our-analysis/are-you-sophisticated-investor>> accessed 7 October 2015

¹⁵ *ibid.*

¹⁶ Gaetane Schaecken Willemaers (n11) 50

2.3 What Are Securities?

A broad definition of a security is that it represents an ownership position in publicly traded company shares,¹⁷ a creditor relationship with a government body or a firm (bonds,¹⁸ sukuk¹⁹ and debt securities),²⁰ or rights to ownership as represented by an option^{21,22}. Each of these categories can furthermore consist of different types.²³ For example, there are different types of shares, such as ordinary and preference shares. It is difficult to include every type of security in laws designed to protect investors. The list of securities varies from law to law.

UK securities legislation, namely the Financial Services and Markets Act 2000 (FSMA), covers these three categories with the added stipulation that the securities have

¹⁷ Three rights are given to an investor who buys shares. The first is the right to vote. The second is the right to take delivery of a corporation's residual cash flows. The third is the right, after all claimants are paid, to the residual assets in liquidation. Stephen J Choi and A C Pritchard, *Securities Regulation: The Essentials* (Aspen Publishers 2008) 10.

¹⁸ Another common security is a bond issued by a corporation to raise capital. With a fixed and certain return, bonds are provided to their owners in the form of periodic interest payments in addition to a final payment when the bond matures (ibid).

¹⁹ An alternative finance investment to bonds are sukuk instruments, which perform an equivalent function to bonds and loans in the western financial system, but which use Shari'ah compliant financial instruments. They are structured to pay a return linked to the assets that the bond has funded, so that they are not paid in a conventional sense. They are a form of asset-based and profit-sharing instrument. Iain G Macneil, *An Introduction to The Law on Financial Investment* (2nd edn, Hart Publishing Ltd 2012) 146.

²⁰ Debt securities are proof of a monetary debt which must be repaid according to certain terms that define the interest rate and maturity/ renewal data. <<http://www.imf.org/external/np/sta/wgsd/pdf/051309.pdf>> accessed 15 February 2015.

²¹ The purchaser has an option rather than an obligation to buy or sell, so the consumer buys the option against a sum of money. The premium paid is the highest loss that the purchaser of an option can suffer. Iain G Macneil (n 19) 154.

²² <<http://www.investopedia.com/terms/s/security.asp>> accessed 16 February 2015.

²³ Each of the securities has advantages and disadvantages. For example, one of the advantages of issuing shares is that the issuing companies do not have to repay the borrowers' money except in the event of liquidation.

to be ‘transferable’²⁴ which means negotiable (able to transfer from one owner to another) on a capital market. In practice, on the London Stock Exchange in addition to ordinary shares, retail bonds and debt securities, there are many other types of securities such as derivatives, exchange traded funds, structured products, exchange traded commodities, covered warrants, GDRS and GILTS.²⁵

In Kuwait, Qatar and Saudi, each legislature has addressed this issue differently. The descriptions are not similar, although all provide for some types of securities. The Saudi legislature, for instance, gives discretionary and flexible power to the Board (The Saudi Capital Market Authority’s Board of Commissioners) to define securities.²⁶ The laws of Kuwait, Qatar and Saudi Arabia include different definitions of securities. In the 2010 Law the Kuwaiti legislature has defined securities as:

Any bond of whatever legal form that proves a share in a marketable finance licensed by authority as:

- A. Shares issued or proposed to be issued in a company’s capital.
- B. Any instrument that originates or proves indebtedness that has been, or shall be, issued by a company.

²⁴ Section (102A) part 2 of the Financial Services and Markets Act 2000 (FSMA) mentions transferable securities which are defined in Article 4.1 (18) of the Markets in Financial Instruments Directive (MiFID) 2004/39/EU. MiFID directive defines Transferable securities as:

‘Transferable securities’ means those classes of securities which are negotiable on the capital market, with exception of payment, such as:

- (a) shares in companies and other securities equivalent to shares in companies, partnership or other entities, and depositary receipts in respect of shares;
- (b) bonds or other forms of securitised debt, including depositary receipts in respect of securities;
- (c) any other securities giving the right to acquire or sell any such transferable securities or giving rise to a cash settlement determined by reference to transferable securities, currencies, interest rates or yields, commodities or other indices or measures;

²⁵ <<http://www.londonstockexchange.com/traders-and-brokers/security-types/security-types.htm>> accessed 16 February 2015.

²⁶ Capital Market Law 2003, Article 2.

- C. Loans, bonds and other instruments that could be convertible into shares in a company's capital.
- D. All marketable general debt issued by various government entities or the public authorities and institutions.
- E. The *sukuk* issued under the applicable Shari'ah-compliant contract forms.
- F. Any right, option or derivative relating to any of the securities.
- G. Units in any collective investment scheme.
- H. Commercial paper, such as promissory notes, letters of credit, fund transfers, exclusively inter-bank traded instruments, insurance policies and the rights of beneficiaries on pension schemes shall not be considered as securities.²⁷

It can be seen that the definition of securities is quite extensive. Further, by eliminating commercial paper from the definition of securities, the legislature has removed any ambiguity on the subject.

The Qatar legislature has defined securities as:

Shares and bonds of Qatar shareholding companies, bonds and notes issued by the government or any Qatari authority or public institution, or any other approved securities. Derivatives, commodities and investment instruments, approved by authority, shall also be considered as securities.²⁸

Qatar does not have an extensive definition of securities.

The Saudi legislature states that the term 'securities' means:

- a. Convertible and tradable shares of companies
- b. Tradable debt instruments issued by companies, the government, public institutions or public organisations
- c. Investment units issued by investment funds
- d. Any investment representing profit participation rights, any right in the distribution of assets, or either or the foregoing, and
- e. Any other rights or instruments which the Board determines should be included or treated as Securities if the Board believes that this would further the safety of the market or the protection of investors. The Board can exercise its power to exempt from the definition of Securities rights or instruments that

²⁷ Capital Market Law 2010, Article 1.

²⁸ Qatari Law No. (8) 2012, Article 1.

otherwise would be treated as Securities under paragraphs (a, b, c, d) of this Article if it believes that it is not necessary to treat them as Securities, based on the requirements of the safety of the market and the protection of investors.²⁹

The legislature also said that commercial bills, such as cheques, bills of exchange, order notes, documentary credits, money transfers, instruments exclusively traded among banks, and insurance policies shall not be considered securities.³⁰

Clearly, in Saudi the Authority's Board of Commissioners has discretionary power to determine what a security is with the proviso that the determination should further the safety of the market or the protection of investors; the Kuwaiti legislature fails to mention this. The Kuwaiti legislature should add the same provisions as in part (e) of the Saudi legislation, to avoid the need to amend the legislation to take into account any developments in the future involving the creation of new types of securities.

See the table below (Table 2.1) for a comparison of securities³¹ and commercial paper in terms of the features of each of these types of financial instruments.³²

²⁹ Capital Market Law 2003, Article 2.

³⁰ Capital Market Law 2003, Article 3.

³¹ Securities are different from bank notes that are issued by central banks because bank notes have a fixed value. Muhammed Ali Sweilem, *Tools To Invest In the Stock Exchange* (Dar University Publications 2013) 12-13.

³² Tamer Saleh, *Legal Protection for Securities Markets* (Dar New University 2011) 83-86.

Feature	Securities	Negotiable (commercial) paper
Brief Definition	Previously defined	Instruments represent the right to cash due and payable within a given time. Can be transferable by endorsement.
Important Types	Shares and bonds	Bill of exchange and cheque (certified cheque, account paid)
Value	Changing value	Fixed value
Issuer	Firms or governments	Firms or individuals
Importance	Increasing in importance	Decreasing in importance because of the of use modern methods
Essential Conditions	Usually by brokers. Trading in a certain place (such as stock exchange)	Trading between individuals. Trading anyplace
Return	Yes	No

Table 2.1 Comparison of Securities and Commercial Paper

There are clearly differences between securities, other investments and other commodities in which people deal.³³ The first difference is that securities unlike goods

³³ The table below (Table 2.2) shows a number of investment types.

Types of Investment	Physical investment, such as real estate	Financial investment, such as stocks and bonds
Multiplicity of Investment	Multi-investment (Portfolio)	Individual investment
Private and Public Investment	Private investment	Public investment (sometimes aimed at social goals in addition to profits)
Nationality of Investment	Foreign investment	Local investment

Table 2.2 Investment Types

Muhammad Ali Sweilem (n 31) 20-23.

are not produced, but they are virtually created without cost. They can be issued in unlimited amounts, because securities are nothing in themselves: they symbolise only an interest in something else. Thus, securities cannot be used to acquire goods and services: they are not a kind of currency. The second difference is that securities are affected by a variety of published information. The third point is that many securities laws contain anti-fraud provisions, since the dealing markets for securities are uniquely at risk from deceptive practices and manipulation. The fourth difference is that securities laws are concerned with regulation to ensure that people and firms engaged in that industry do not gain from their superior experience at the expense of small investors. The fifth difference is that a range of government sanctions are provided to punish those who break the rules and the securities laws.³⁴ It is apparent, therefore, that, because of their nature, securities need special regulation.

2.4 Securities Law and Financial Regulation

In some countries, such as the UK, securities law is part of financial regulation while in other countries, such as Kuwait, securities are regulated by separate and special laws called ‘Securities Laws’.

In the context of securities laws, the following is an introduction to financial regulation and other laws that protect investors.

2.4.1 What is Securities Law?

Securities markets, including stock exchanges, are important for the financial systems as a whole, because they represent the arteries that feed the national economy with enough

³⁴ David L Ratner and Thomas Lee Hazen, *Securities Regulation in a Nutshell* (10th edn, Thomson West 2009) 3.

money to function properly.³⁵ There is also an overlap between the banking sector and capital markets: both have an effect on economic development, as through them savings turn into productive investments.³⁶ Securities markets and the banking system complement each other, and both should be promoted to have appropriate resources for financial investments.³⁷ It is important to regulate the securities market because of its potential impact on the financial system as a whole.

There is also a need for special regulation of securities because of their nature. For example, shares are intangible in nature. The holder of them owns future entitlements, rights or benefits, such as dividends, voting rights, and the return of capital, the value of which can go up or down. They are not pieces of tangible property that can be used or consumed, such as land or goods. As a result, special requirements and conditions are required by securities laws.³⁸ Commercial law which is the rationale for statutory regulation of commercial activities cannot provide enough protection in investment markets, because of the importance of having timely and full information in a fair way. There are also systemic risks in investment markets which bring various types of risks.³⁹ For more details see chapter one.

As previously stated, this thesis discusses the protection of retail investors, small, private and individual investors on stock exchanges in secondary markets. There are important differences between the securities market and traditional market for goods

³⁵ ‘Entrance to the Capital Markets’ (Qatar Financial Markets Authority) 13 <http://www.qfma.org.qa/App_Themes/AR/ABook/Introduction_to_capital_markets.pdf> accessed 16 March 2014.

³⁶ Elham Wahid Daham, *The Effectiveness of the Performance of Capital Markets and Banking Sector in Economic Growth* (National Center For Legal Publications 2013) 63.

³⁷ Mohamed Helmy Abdel Tawab (n 4) 336.

³⁸ Robert Baxt, Ashley Black and Pamela Hanrahan, *Securities and Financial Services Law* (6th LexisNexis 2012) 7-8.

³⁹ Iain G MacNeil (n 19) 20.

and services⁴⁰ as is shown in the table below (Table 2.3). Because of these differences the protection of investors requires a different approach.

Type of market	Traditional Market	Securities Market
What is traded	Goods & real estate	Shares, bonds & other types
The necessity of the presence of intermediaries	Unnecessary	Important
How to implement the contract	Payment & delivery	Special way of delivery & payment.
Physical presence of goods	Usually needed	Not needed
The volume of transactions	Varies	Huge, frequent & focused
Announcement of prices	Do not announce prices for each deal	Official & daily announcements

Table 2.3 Differences Between Traditional and Securities Markets

Some countries, like the UK, have a single regulatory authority that is responsible for the regulation of the whole financial system,⁴¹ including the protection of consumers of financial products and services.⁴² On the other hand, other countries, like Kuwait, separate the regulation of securities from the regulation of other financial services. Therefore, the UK legislation gives the Financial Conduct Authority (FCA) more power and a broader scope. However, in Kuwait the Capital Market Authority is only responsible for regulating securities activities. Therefore, one of its aims is to protect investors in securities and not in the whole variety of financial services. This will be discussed later.

⁴⁰ Mohammed Choukri Aladawa, *Stock Exchange in the Balance of Islamic Law* (Dar Thought University 2012) 26-28.

⁴¹ According to part 1A, section 1I of the Financial Services Act 2012, the UK financial system includes ‘a) financial markets and exchanges; b) regulated activities; and c) other activities connected with financial markets and exchanges’.

⁴² Financial Services Act 2012, part 1A, section 1B.

In Kuwait, the scope of the regulatory authority's responsibilities to regulate financial systems is limited to securities activities, while the major responsibility for financial systems lies with the central banks. For example, in Kuwait, protecting consumer loans, commissions, fees and credit cards is the responsibility of the Central Bank. Terms and conditions about the rights and obligations of consumers of financial services and products are the responsibility of the Kuwaiti Central Bank. Figure 2.3 shows the Central Bank's roles according to Law No 32 of 1968, concerning currency, the Central Bank of Kuwait and Organisation of Banking Business, Law No. 41 of 1993 Concerning State Purchase of Select Debts and Collection Procedure, Law No. 30 of 2008 with Regard to Guaranteeing the Deposits at Local Banks in the State of Kuwait and Law Decree No. 2 of 2009 with Regard to Reinforcing the Financial Stability in the State.⁴³ A similar approach to regulation exists in Saudi Arabia and Qatar.

⁴³ The Forty-First Annual Report of the Central Bank of Kuwait for the Fiscal Year 2012/13, <<http://new.cbk.gov.kw/en/index.jsp>> accessed 14 March 2014.

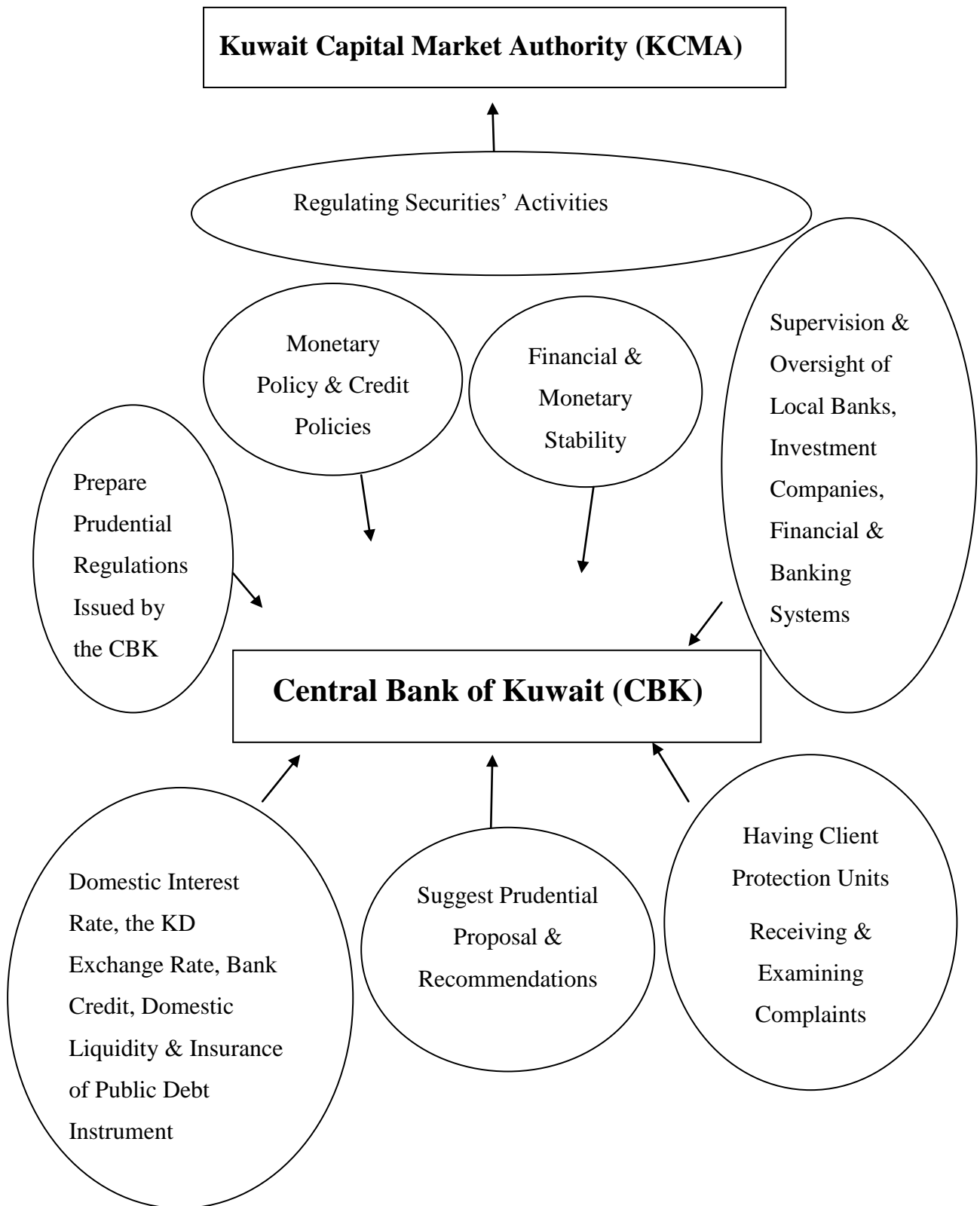


Figure 2.3: Stylised diagram of the main responsibilities of Kuwait Capital Market Authority (KCMA) and the Central Bank of Kuwait (CBK).

It is generally accepted that regulation can play a significant role in the stability of the financial system.⁴⁴ It is appropriate here to look at the meaning of financial regulation, which includes securities regulation.

2.4.2 Financial Regulation⁴⁵

Generally speaking, financial markets refer to the meeting place where one party has money to invest and another party has an idea of investment that needs money.⁴⁶ Moreover, Robert Shiller says that financial markets are not just about trading. Financial markets include banking, insurance, securities, future markets, and the derivatives market.⁴⁷ There are four main types of financial services namely, banking, securities, insurance and non-bank credit.⁴⁸

Robert Shiller divides financial market regulation into five types. The first is within a company. When a company sets its own rules, these are called inertial rules. The board, including inside and outside directors, imposes certain principles. Shiller states that members of a board owe two important duties to the firm. Firstly, they owe the duty of care; namely, the director must know what he is doing, which includes acting as a reasonable person, who obtains information, watches and is careful about his obligations as a member of the board. The second is the duty of loyalty, not simply to the shareholders, but also to the firm. There is a growing belief that loyalty has been extended to stakeholders, other people and the community as a whole.

⁴⁴ Frank Partnoy, 'Financial Systems, Crises, and Regulation' (University of San Diego, Research Paper 2014 No 14-154) 2 <http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2435332> accessed 28 January 2015.

⁴⁵ Robert Shiller, 'Financial Market 2011' (Open Yale University courses I Tunes).

⁴⁶ Mokhtar Hamida, *Privatisation Through The Financial Markets* (Hassan Modern Library 2013) 87.

⁴⁷ Robert Shiller (n 45).

⁴⁸ 'Good Practices for Financial Consumer Protection' (2012) World Bank working paper 5.

The second type of regulation refers to trade groups or ‘self-regulation’, when groups of firms or people decide to pass rules among themselves to form an organisation. Self-regulation occurs when regulations are specified, administered and enforced by the organisation itself.⁴⁹ Self-regulatory organisations (SROs) should be subject to the oversight of a regulatory authority.⁵⁰

Robert Shiller cites the New York Stock Exchange as an example of a trade group. As there was no organised stock exchange, in 1792 stockbrokers signed an agreement setting up the Stock Exchange to regulate the prices and the commissions. Twenty-four stockbrokers gathered under a buttonwood tree outside the building located at 68 Wall Street to sign the agreement known as the ‘Buttonwood Agreement’. This agreement remained until 1974 when the government broke the monopoly. Over time, Wall Street has come to represent the financial markets of the United States as a whole.⁵¹

The third type of regulation is local regulation. For example, the American Blue Sky Laws are financial regulations issued by each state. The first was issued in 1911 in Kansas, and almost every state had its own law until the 1930s. The fourth type is national regulation. To complete the previous example, after 1934, all listed companies in the United States were regulated by the Securities and Exchange Commission (SEC). This kind of regulation will be discussed later in more detail.

⁴⁹ Ian Bartte and Peter Vass, ‘Self-Regulation and the Regulatory State: a Survey of Policy and Practice’ (University of Bath, Research Report 17) 22.

http://www.bath.ac.uk/management/cri/pubpdf/Research_Reports/17_Bartle_Vass.pdf accessed 11 February 2014.

⁵⁰ IOSCO Objectives and Principles of Securities Regulation (2010) principle 9 <http://www.iosco.org/library/pubdocs/pdf/IOSCOPD323.pdf> accessed 26 February 2014.

⁵¹ <http://www.nyx.com/en/who-we-are/history/new-york> accessed 11 February 2014.

The fifth type of regulation is international. There are a number of international organisations, such as the International Monetary Fund (IMF),⁵² the Bank of International Settlements (BIS)⁵³ and the Basel Committee on Banking Supervision (BCBS).⁵⁴ One problem with national regulations is that people leave the country if they do not like the regulations. Therefore, attempts to have international regulations include: 1) the BIS in Basel in 1930, which includes 57 central banks and which suggests rules that have a real effect even though they are not enforceable by law; 2) The Basel Committee of 1974, which suggested bank regulations and was followed by Basel 1 in 1988, Basel 2 in 2004 and Basel 3 in 2010; 3) the G6, which comprises six major countries: France, Germany, Italy, Japan, the US and the UK. In 1976, Canada was added, and the group became the G7. In 2008, the group was extended to be the G20 to represent the leading financial countries in the rest of the World. In 2009, the G20 created the Financial Stability Board (FSB) located in Basel to report recommendations to the G20 about the world's financial systems. This thesis will not discuss Basel.

Although, each of the above regulations can play a significant role in protecting individual investors, this research will focus on national regulation. National financial market regulation can be divided into two categories, namely prudential regulation and the conduct of business regulation. Prudential regulation is about controlling the solvency and liquidity of participants in financial markets.⁵⁵ The conduct of business regulation focuses on the relationship between firms and customers, such as disclosure rules.⁵⁶ The conduct of business regulation includes preventing market abuse and

⁵² 187 countries are members of the IMF. It has a number of objectives and functions, such as maintaining financial stability by developing international cooperation, encouraging international trade, reducing global poverty, encouraging high levels of employment, and providing loans. In addition, it monitors, advises, educates and trains the financial and economic police for its 187 member countries; Nicholas Ryder, Margaret Griffiths and Lachmi Singh, *Commercial Law: Principles And Policy* (CUP 2012) 464.

⁵³ It supports central banks to maintain monetary and financial stability. It has a number of objectives and functions, such as promoting discussion among central banks; *ibid* 465.

⁵⁴ It has a number of objectives and functions, such as improving awareness and enhancing the levels of banking supervision. *Ibid*.

⁵⁵ Iain G McNeil (n 19) 36.

⁵⁶ *ibid* 37.

ensuring that firms treat consumers fairly.⁵⁷ Prudential regulation can be separated into macro-prudential regulation and micro-prudential regulation.⁵⁸ The latter is about ensuring that the solvency of individual financial firms is not compromised by excessive risk-taking or other questionable practices, while the former is about protecting the stability of the financial system as a whole.⁵⁹ Micro-prudential regulation includes promulgating principles that firms must observe to ensure that they conduct their business in a prudent matter.⁶⁰ Macro-prudential regulation, which is largely an economic activity, is beyond of the scope of this thesis. For example, in the UK, the macro-prudential function is carried out by the Financial Policy Committee (FPC). The responsibility for micro-prudential regulations is divided between the FCA and the Prudential Regulation Authority (PRA). The latter is responsible for banks, large deposit-takers and others, the failure of which can impact the system as a whole. 1400 financial groups are being supervised by the PRA, while approximately 23,000 firms are supervised by the FCA.⁶¹

The question here is: how to regulate the financial system? For example, in the UK before and during the 2008 financial crisis there was a conflict between prudential supervision and the conduct of business supervision. It was difficult for one body to reconcile them. The former is largely an economic activity, while the latter is often performed by lawyers. A tripartite committee, which was responsible for financial stability in the UK and included the Treasury, the Bank of England and the FSA, was not able to limit that conflict. The FSA focused too much on the conduct of business at the expense of micro-prudential supervision.⁶² To reduce the conflict, there is a new approach that gives the Bank of England responsibility for micro-prudential supervision

⁵⁷ Emma Murphy and Stephen Senior, 'Changes to the Bank of England' (2013) 20 <<http://www.bankofengland.co.uk/publications/Documents/quarterlybulletin/2013/qb130102.pdf>> accessed 4 April 2014.

⁵⁸ This distinction between regulations first occurred in 2000, while in the past there was a mixture between them. Robert Shiller (n 45).

⁵⁹ Iain G McNeil (n 19) 36.

⁶⁰ Emma Murphy and Stephen Senior (n 57) 20.

⁶¹ *ibid.*

⁶² <<http://www.publications.parliament.uk/pa/ld200809/ldselect/ldeconaf/101/10108.htm>> accessed 11 January 2014.

(shadow banking sector), which means that it oversees some individual firms in addition to macro-prudential supervision (financial stability of the economy) and its monetary policy role.⁶³ This will be discussed in detail in Chapter Six.

There are two ways of looking at finance. The first is to focus on the theory of finance, which views financial economics as a scientific discipline. The second is about solving problems in practice.⁶⁴ However, there is no clear scientific solution to these problems. One of these problems is how to protect individual investors. This thesis will try to present a way of protecting individual investors under securities law.

2.5 Protection of Investors under Securities Law

Finance, including investment problems, affects business, individuals, governments and financial systems as a whole. Protecting investors in securities markets is not just beneficial for investors themselves, but also protects the financial system as a whole. This is evident from three angles: firstly, the effect of the retail financial market on the recent financial crisis of 2008; secondly, an increasing number of individuals invest in a collective investment scheme (CISs); thirdly, there is more political interest because of retirement aims that are affected by securities markets.⁶⁵

As there is no clear definition of what protecting investors means, this thesis will address the problems from the view of what investors are looking for. Firstly, they seek a fair price that has not been influenced by market abuse. Secondly, they require fair disclosure of inside information. Thirdly, they want to be able to rely on good behaviour by managers. Lastly, they expect sound legislation to protect their interests. The

⁶³ *ibid.*

⁶⁴ Nico Van Der Wijst, *Finance: A Quantitative Introduction* (Cambridge University Press 2013) 2.

⁶⁵ Niamh Moloney, *How to Protect Investors: Lessons from the EC and the UK* (Cambridge University Press 2010) 2-3.

following section considers these four areas of protection that will be covered in this thesis.

2.5.1 Fair Trading Prices

A key point in finance, including investment, is about the future valuation of assets and about financial expectation relying on time and uncertain elements.⁶⁶ Finance, including investment studies, involves money, risk and time, which help people to select between uncertain future values.⁶⁷ That is what investors pay for. The market price today reflects the future of the cash flow and risk. These issues mean that regulations for the protection of investors are complex but are needed in financial markets.

The financial market includes a number of players such as 1) investment managers, who manage portfolios of share and bond companies; 2) chief executive officers; 3) bankers; 4) investment bankers, who help to sell new securities; 5) traders and market makers (who benefit from short-run movement work, like speculators); 7) market designers; 8) derivative providers (future, option and swap); 9) lawyers and financial advisors; 10) lobbyists⁶⁸ (who have the ability to influence the government); 11) regulators (government regulatory or self-regulatory organisations); 12) accountants and auditors

⁶⁶ Nico Van Der Wijst (n 64) 4.

⁶⁷ Investment is made directly or through agents, such as business and fund managers.

⁶⁸ Arthur Levitt, Chairman of the SEC from 1993 to 2000, mentioned that,

...during my seven and a half years in Washington, I was constantly amazed by what I saw. And nothing astonished me more than witnessing the powerful special interest groups in full swing when they thought a proposed rule or a piece of legislation might hurt them, giving nary a thought to how the proposal might help the investing public. With laser-like precision, groups representing Wall Street firms, mutual fund companies, accounting firms, or corporate managers would quickly set about to defeat even minor threats. Individual investors, with no organised lobby or trade association to represent their views in Washington, never knew what hit them.

Arthur Levitt (with Paula Dwyer) *Take On The Street: What Wall Street and Corporate America Don't Want You To Know; What You Can Do to Fight Back* (Pantheon E Books) 461.

(bookkeepers); 13) policy makers; and 14) securities brokers. Any of these people could behave in a way that affects the fairness of price either through misrepresentation, omitting information about securities, manipulation of the market prices of securities, selling unregistered securities or insider dealing. The last action will be discussed in detail in Chapter Three.

2.5.2 Fair Disclosure

Fair disclosure means timely and full disclosure. There are different forms of disclosure obligations on an issuer. The first is periodic disclosure (including annual reporting and accounts). Usually, this type of disclosure is required in a specific period of time. Another disclosure obligation relates to prospectuses and listing particulars. Finally, there is ongoing disclosure obligations (including inside information disclosure) required as soon as possible after certain information is known.

Inside information is specific, non-public information which if published would have an effect on securities prices. Different actions can constitute unfair disclosure namely, non-disclosure, limited disclosure, false disclosure, delayed disclosure and disclosure constituting misrepresentation. Lack of fair disclosure of inside information can harm investors because investors rely on such information to make informed investment decisions (buy, sell or defer investment). In terms of legislation unfair disclosure can be either a criminal or civil offence. This will be discussed in detail in Chapter Four.

2.5.3 Misbehaviour by Managers

In the last fifty years, many changes have occurred in the style of company ownership depending on the country. Nationalised industries have been privatised, and there has been a move away from family-owned firm to firms with diverse shareholders made up of individuals and institutions. This separation sometimes causes bad behaviour by managers of parties involved on secondary markets, such as advisors, analysts, hedge

funds, auditors, collective investment schemes (CIS),⁶⁹ market intermediaries (brokers or investment banks), market operators and issuers (companies). A number of companies have been ruined as a result of poor corporate governance.⁷⁰ The bad behaviour by company managers will be discussed in detail in Chapter Five.

2.5.4 Finding Sound Financial Regulations

Sound financial regulation is required to protect investors from unfair prices, unfair disclosure and misbehaviour by managers. Regulating financial markets including stock exchanges is a complex issue. For example, in the financial industry, it is straightforward to say that fraud is bad, but a debate would arise about what transactions are considered to be fraud.⁷¹ In the modern thinking of lawyers, three instruments could help to regulate financial markets, primary legislation, secondary legislation allowing a regulatory authority to make rules and voluntary codes. The first two are often referred to as ‘Hard Law’ while the last is known as ‘Soft Law’.⁷² The latter aims to change the business culture of an organisation. An example of financial culture acting as a deterrent is a bank that takes high risks. This will affect its reputation and, in turn, people will refuse to deposit their money with that institution.⁷³ The way to improve laws, pass rules and benefit from the financial culture will be discussed in Chapter Six.

2.6 Protection under Other Laws

Measures for protecting investors are not limited to securities law. In the UK securities legislation consists of the Financial Services and Markets Act 2000 (FSMA) and the Financial Services Act 2012 (FSA). However, there are others laws and standards which

⁶⁹ Pooling assets of a number of investors by professional independence managers.

⁷⁰ Bob Tricker, *The Economist: Directors, An A-Z Guide* (Profile Books 2009) 2.

⁷¹ Justin O’Brien and George Gilligan, *Integrity, Risk and Accountability in Capital Markets: Regulating Culture* (Hart Publishing 2013) 3.

⁷² *ibid* 4.

⁷³ *ibid*.

protect investors even though they are not investor specific. For example, the law covering bribery, fraud, company law and accounting law, such as EU Directives 2013/34/ and 2014/56,⁷⁴ as well financial reporting standards such as the Generally Accepted Accounting Principles (GAAP) in the UK.

Securities law protection differs from protection under others laws on two counts. For example, securities law only covers securities activities while other law covers securities and other commercial activities. In addition, company and accounting law covers listed and unlisted companies but not foreign listed companies, while securities law covers all listed companies whether foreign or national, but not unlisted national companies.

The methods of enforcing, supervising and policing compliance with securities law is also different. There is a specific body responsible for the enforcement and supervision of compliance with securities laws. This area of law covers a mixture of statutory provisions also known as ‘Hard Law’ and voluntary provision known as ‘Soft Law’ such as the “Comply or Explain” principle, whereas other laws consist solely of ‘hard law’. This will be discussed later.

2.6.1 Fraud and Bribery Legislation

The crime of corporate fraud is defined in the Fraud Act 2006 (UK). It states that a person by their action, or lack of action, may be found guilty of fraud if they breach or commit any of following: fraud by false representation,⁷⁵ fraud by failing to disclose information⁷⁶ or fraud by abuse of position.⁷⁷ The Fraud Act 2006 will not be considered in this thesis because there is an overlap between the provisions of the Fraud

⁷⁴ Directive 2013/34/EU concerns how companies should draw up their annual financial statements.

⁷⁵ Fraud Act 2006 s2.

⁷⁶ Fraud Act 2006, s3.

⁷⁷ Fraud Act 2006, s4.

Act 2006 applicable to investors and the securities legislation, so an analysis of the latter suffices.

Bribery is an example of an offence which can harm investors. However, it is not covered by securities legislation but by the Bribery Act 2010. The risk of bribery applies to all companies, large and small, and it needs to be countered because it harms investors. Receiving and offering bribes can damage society and economic growth. Bribery damages competition and free markets and also rewards unethical behaviour.⁷⁸ It can harm investors in one of two ways. The company which pays the bribe is actually depressing its profit which has an effect on its own shareholders. There can also be an adverse effect on the shareholders of a competing firm which may have lost out because of the unfair advantage created by the bribing action of its competitor. On the other hand, some could argue that without bribery the company would not get business, especially with overseas countries. For example, Hewlett- Packard (HP) bribed public officials in Poland, Russia and Mexico in order to win public contracts.⁷⁹ In the UK, the Bribery Act 2010 was passed to create some new offences that apply to all companies that do business in the UK. The Former Secretary of State for Justice in the UK, Kenneth Clarke, supported this idea in the Foreword to the Guidance of the Bribery Act 2010 by saying ‘we do not have to decide between tackling corruption and supporting growth’.⁸⁰

Section 6 of the Act addresses the offence of bribing foreign public officials. This is different from the general bribery offences set out under section 1, relating to bribing⁸¹

⁷⁸ <<http://www.theguardian.com/sustainable-business/blog/eliminating-corruption-crucial-sustainability>> accessed 8 February 2015.

⁷⁹ *ibid.*

⁸⁰ The Bribery Act 2010 - Guidance, <<http://www.justice.gov.uk/downloads/legislation/bribery-act-2010-guidance.pdf>> accessed 9 October 2013.

⁸¹ Under section 1 of the Act 2010, general crime (bribes), and individual commits fraud:

If he or she promises or gives or offers financial or other advantages to another person (natural or legal person) (1) intending to induce (before the actions) or reward (after the actions) that person. or (2) knowing or believing the acceptance would constitute itself

another person, and under section 2 relating to the person being bribed.⁸² The two offences of bribing and being bribed replace the common law offences and the Acts of 1889, 1906 and 1916.⁸³

Under section 6, a person commits a crime if he or she bribes a foreign public official⁸⁴ on condition that the bribe is intended to influence the capacity of the foreign public official. Part (2) of section 6 mentions that the bribery must have the intention to get or to keep hold of business or an advantage in conducting business. According to section 6 part 3b, the only exemption is if there is an applicable written law that allows influence

improper performance (test of a reasonable person in the UK) of a relevant function or activity (That including (a) any function of a public nature, (b) any activity connected with a business, (c) any activity performed in the course of a person's employment, (d) any activity performed by or on behalf of a body of persons) that could happen directly or through a third party.

⁸² Under section 2 of the 2010 Act, there are different offences relating to being bribed, such as requesting, agreeing or receiving or accepting financial or other advantages.

⁸³ Stephen Bloomfield, *Theory and Practice Corporate Governance: An Integrated Approach* (Cambridge University Press 2013) 113.

⁸⁴ According to section 6 part 5 of the Bribery Act. Part (5) 'Foreign public official' means an individual who—

(a) holds a legislative, administrative or judicial position of any kind, whether appointed or elected, of a country or territory outside the United Kingdom (or any subdivision of such a country or territory),

(b) exercises a public function— (i) for or on behalf of a country or territory outside the United Kingdom (or any subdivision of such a country or territory), or (ii) for any public agency or public enterprise of that country or territory (or subdivision), or

(c) is an official or agent of a public international organisation.

Part (6) 'Public international organisation' means an organisation whose members are any of the following—

(a) countries or territories,

(b) governments of countries or territories,

(c) other public international organisations,

(d) a mixture of any of the above.

by such things (offer, promise or gift). The question here is whether there is a country that allows its officials to be bribed.

Section 7 of the Bribery Act (UK) refers to a commercial organisation which could be guilty of an offence if a person associated with it, who performs services for the commercial organisation or on its behalf, such as an employee, agent or subsidiary, uses bribery to obtain or retain business or secure an advantage in the conduct of business. However, it is a defence for the company to prove that it had in place adequate procedures to prevent such things. The Act treats a company as a separate body, which has its own entity and its own responsibilities.⁸⁵ Any fine against the company could affect innocent shareholders. However, some argue that shareholders must be more careful when they elect the board.⁸⁶

The penalties for individuals include imprisonment for up to ten years and an unlimited fine for the company. In the UK the first conviction under the Bribery Act at Southwark Crown Court was on 5th December 2014 against a former Director and Chief Commercial Officer of Sustainable AgroEnergy plc (SAE), Gary West, who was convicted of being bribed under s.2 of the Bribery Act. The second man, Stuart Stone, who was convicted under s.1 of the Bribery Act of offering or giving bribes, was a sales agent of unregulated pension and investment products for a separate company. West received bribes from Stone.⁸⁷

⁸⁵ John Rupp, 'The UK Bribery Act 2010 and its implications for businesses: Corporate Governance for Main Market and AIM companies' (2012) White Paper, London Stock Exchange 115.

⁸⁶ Stephen Bloomfield, *Theory and Practice of Corporate Governance: An Integrated Approach* (Cambridge University Press 2013) 112.

⁸⁷ <<http://www.corderycompliance.com/23-million-bribery-case-leads-to-28-years-in-jail/>> accessed 5 October 2015

Neither Kuwait, Saudi Arabia nor Qatar⁸⁸ has a law such as the Bribery Act 2010. Section 6 (bribery of foreign public officials) and section 7 (failure to prevent bribery in commercial organisations) may provide good examples for these countries to follow. In Kuwait, for a criminal offence to be committed a bribe has to be given to a government official in Kuwait.⁸⁹ Kuwait needs to pass the kind of special legislation on bribery that exists in the UK, which is more extensive because it seeks to prevent bribery inside and outside the UK in both the private and public sectors.⁹⁰

Article 35 of Kuwaiti Criminal Law of 1960 mentions that bribery occurs if a public officer ‘government employee’ requests or obtains something (money, gifts or any types of interests) in consideration of the fulfillment of his duty. Article 43 states that any employee working in a company in which the government has a share is deemed to be a public official for the purposes of the Kuwaiti bribery legislation. In effect Kuwait has limited the protection to listed companies if the Kuwaiti government owns part of the shares. However, in the UK the Bribery Act extends the protection to cover the employees of any listed companies regardless of whether the government owns part of the company or not and Kuwait ought to follow the example of the UK.

2.6.2 Protection under Company Law

Under company law, shareholders have some protection, but it is limited to certain actions, such as the right to approve important decisions such as amending the Articles of Association and electing or removing directors.⁹¹ In the UK, there are some rights

⁸⁸ They rely on the idea of the public officer. For more details, see Saudi Arabia Anti Bribery Regulation 1991 Article 9, Qatari Law No. 11 of 2004 issuing the Penal Code Article 140 and Kuwaiti Criminal Law enacted 1960 amended 1970 and in 2010 Article 35.

⁸⁹ *ibid* Kuwaiti Criminal Law.

⁹⁰ John Rupp (n 85) 126.

⁹¹ Henry R Cheeseman, *Business Law: Legal Environment, Online Commerce, Business Ethics, and International Issues* (8th edn, Pearson 2013) 618.

available under company law to protect minority shareholders;⁹² for example, any shareholder can demand a copy of the company's last annual reporting statements.⁹³ Furthermore, a member (shareholder) can apply to the court for unfair prejudice to the shareholder.⁹⁴ If the court agrees it may compensate the shareholder or regulate future conduct of the company. Examples of prejudicial conduct are mismanagement, the majority taking financial advantage of minority shareholders, exclusion from management, non-payment of dividends or reducing dividends by paying excessive remuneration and improper allotments.⁹⁵

Some people feel that company law should go further to protect investors from board actions which may adversely affect the company's share price and even jeopardise its survival. Some examples are: when a board member takes money from the company, takes advantage of his position by selling a company's assets to relatives at a low price, buys at a high price to favour someone, pays a favoured employee a high salary, or deals as an insider. Minority shareholders need to protect their investment against the majority who have the power to influence the board of directors.

It is felt that board appointments are dominated by majority shareholders and the company's interests would be better served if minority shareholders had more say in the appointment of a company board. One way of doing this would be through cumulative voting.⁹⁶ However, there is no guarantee that this would be of benefit to minority

⁹² Majority and minority shareholders can be described as controlling and non-controlling shareholders respectively; Paul Davies, *Introduction to Company Law* (2nd edn, Oxford University Press 2010) 218-219.

⁹³ 'Protection For Minority Shareholders' (2014) Institute Of Directors working paper 3.

⁹⁴ Company Act 2006 s994.

⁹⁵ Natasa Flourentzou, 'Minority Shareholders: Applicability of Unfair Prejudice' (ms lawyers)

http://www.mslawyers.eu/images/publication_documents/Minority_Shareholders-Applicability_of_Unfair_Prejudice.pdf accessed 9 February 2015.

⁹⁶ Saudi Corporate Governance Code 2006 articles 1 and 6 state that accumulative voting gives the minority more chances to appoint their representatives on the board, and it shall be used in voting when nominating the board members in the General Assembly.

shareholders, because most board decisions require a simple majority. However, cumulative voting does give minority shareholders better access to information about board practice and decisions.

Cumulative voting⁹⁷ still involves the one share equals one vote principle. This is different from multiple votes equal one share. For example, an A share has one vote; a B share has 10 votes. There are a number of critical points relating to the ten vote equals one share system, which is not in the company's interest. For example, this system reduces the value of the stock, because a share has two rights, one about profit and the other about voting, so that the voting right affects the price. On the other hand, some people believe that long-term investors should be given more voting power because of their loyalty.⁹⁸

⁹⁷ How Does Cumulative Voting Work?

The number of candidates is not important in Cumulative Voting; however, the number of directors at a board affects the percentage of success. The lower the number, the higher the percentage required. There are two ways of selecting the board.

1- Straight Voting (Barriers between directors)

Owner name	Owner share	Position 1	Position 2	Position 3	Total vote
A	5 shares	5 Votes	5 Votes	5 Votes	15 Votes
B	2 shares	2 Votes	2 Votes	2 Votes	6 Votes

It can be seen from the table that A will win all the positions; therefore B cannot win any seat (position), and no one can be representative B in a board. B cannot put all of his votes (6 votes) in one place, because there are boundaries between the positions.

2- Cumulative Voting (No barriers)

In the table above, B can accumulate (allocate) all shares (6 votes) in one position to select his representative on a board.

In another situation, if C has 4 shares (total of 12 shares), combined with B, they have a total of 6 for any position. Therefore, there is no chance for A to win any seat in straight voting, while in commutative voting, A will win at least one seat; Henry R Cheeseman (n 92) 621.

⁹⁸ Andrew Chambers, *Corporate Governance Handbook* (5th edn, Bloomsbury Professional 2012) 370.

In some countries, like the UK,⁹⁹ company law does not dictate the method of voting for directors. Therefore, although a company may write this into its Articles, some people feel that it should be a statutory provision. An attempt was made in 2012 in Kuwait to make cumulative voting mandatory, because it was felt that this was needed to give extra protection to minority shareholders to improve corporate governance.¹⁰⁰ This change was introduced after the company law had been in existence for 53 years with no mention at all of cumulative voting. Yet, four months after making cumulative voting mandatory, the legislature changed its mind and made cumulative voting optional once again. The speed of this reversal was very strange, since traditionally Kuwait takes a long time to implement changes. As a result of this change, it was thought that the majority of firms would not adopt cumulative voting. The legislature was criticised for changing its mind by Dr. Fayez al-Kandari, a law professor at Kuwait University, in an article entitled ‘Legal Opinion: Why cancel mandatory cumulative voting?’,¹⁰¹ and was accused of bowing to pressure from influential businessmen, who benefitted by maintaining the status quo.

Some argue that if cumulative voting were part of company law it would apply only to national companies and would not apply to foreign companies listed on the stock exchange. A better option would be to make such a provision part of the securities law as well as the company law. Securities law would apply to all companies regardless of nationality. The Kuwaiti 2013 Corporate Governance Code requires that cumulative voting be used to elect the directors.

2.6.3 Protection under Accounting Law

Companies may try to exaggerate their performance by how they report their earnings. A number of accounting scandals during the late 1990s and the early 2000s caused huge

⁹⁹ Andreas Cahn and David C Donald, *Comparative Company Law: Text and Cases on the Law Governing Corporations in Germany, the UK and the US* (Cambridge University Press 2011) 479.

¹⁰⁰ Kuwaiti Company Law 2012 amended in 2013, Article 240.

¹⁰¹ <<http://www.alqabas.com.kw/node/761115>> accessed 3 October 2013.

losses to investors (shareholders).¹⁰² Laws and regulations can reduce the ability of companies to ‘cook the books’ or to participate in ‘accounting games’.¹⁰³ However, accounting rules try to limit the company’s power to determine what methods to follow.

Investors tend to look at published annual reports and accounts, such as balance sheets,¹⁰⁴ profit and loss accounts (P&L)¹⁰⁵ and cash flow statements¹⁰⁶ for reassurance, because they presume that annual reports and audited financial records represent a company’s health. However, as recent corporate failures have demonstrated financial statements, even audited ones, have proved to be unreliable. Below is a list of techniques that have been used to ‘cook the books’¹⁰⁷ to mislead investors.

1- Off Balance Sheet Vehicles

Liabilities and assets are not included on a balance sheet. One way of doing this is to buy another company and then have the other company borrow money.

2- Capitalising expenses

This involves treating an expense as if it were capital. For example, Worldcom crashed because the company capitalised expenses to show a large profit that did not exist. The company put the expenses on the balance sheet as assets; they should have been in the

¹⁰² Henry R Cheeseman (n 92) 633.

¹⁰³ Roger L Martin, *Fixing The Game: How Runaway Expectations Broke the Economy and How to Get Back to Reality* (Harvard Business Review Press 2011) 86.

¹⁰⁴ A balance sheet is defined as a financial statement, which shows an assets account (fixed and current assets) and liability account as of a fixed date, and the balance sheet must balance. Roger Mason, *Bookkeeping and Accounting In a Week* (4th edn, Hodder Education 2012) 86.

¹⁰⁵ A profit and loss account (P&L) is defined as a financial statement, which shows all of the revenue and expense items during a certain period, such as 3, 6 or 12 months; *ibid* 72.

¹⁰⁶ The cash flow statement concerns the money coming into and out of the business relating to operations, investing and financing. It is important, because it shows the profits on paper and the cash in the bank. Richard Baker, *Short Introduction to Accounting* (CUP 2011) 31-39.

¹⁰⁷ Lee Ann Obringer, ‘How Cooking the Books Works’, <<http://money.howstuffworks.com/cooking-books1.htm>,> accessed 20 October 2013.

P&L statement. The company treated the expenses as assets to show falsely that it had substantial assets; in fact, these were not assets but operational costs.

3- Manipulating the timing of expenses

Income can be taken only when there are invoices. Consequently, if a contract is over a period of time, the revenue and cost also must be over a period of time. However, some companies try to put all of the revenue and expenses into the profit and loss account when they sign a contract. What then happens if something goes wrong with the contract?

Other examples:

- Recording sales just after the order but before the goods are shipped.
- Recording incomes without taking into account goods returns strategy.
- Not recording discounts.
 - 4- Non-recurring expenses and pension manipulation

A company guarantees to pay an employee a specific amount based on a final salary and years of service. To guarantee this, companies have to put money in a fund and invest the money. One safe investment is a cash bond, which pays interest and secures the capital. However, some companies invest in the stock exchange, which involves more risk. They forecast by how much the interest will appreciate and calculate their contributions accordingly. They might underestimate their contribution to keep their profit high. If the fund does not grow sufficiently, there will not be enough money to pay pensions: this is known as a 'hole' in the pension fund. An example is the Royal Mail.¹⁰⁸

Some of above problems are compounded by poor auditing, as in the case of Enron. The auditor Arthur Andersen knew about the accounting fraud but did nothing about it. They were found guilty of destroying documents related to Enron's auditing.¹⁰⁹ To stop this kind of accounting fraud certain laws require firms to follow accounting reporting standards when they prepare their financial reports. It is also important to have auditing

¹⁰⁸ 'Royal Mail IPO: A Windfall to Fill a Hole?' <<http://blogs.wsj.com/moneybeat/2013/09/12/royal-mail-ipo-a-windfall-to-fill-a-hole/>> accessed 22 October 2013.

¹⁰⁹ 544 US 696 (2005)

standards and to have a public body to oversee the auditing profession. Accurate and reliable published accounts reduce the risks of an investor making a poor investment decision.¹¹⁰ However, it is not easy as it is complex and there is a financial cost to complying.

In the UK, from 1947 companies have had to follow the UK accounting framework GAAP to present a “true and fair view” (TFV).¹¹¹ In 2005, GAAP required public companies to follow International Financial Reporting Standards (IFRSs)¹¹² as adopted by EU Directive 1606/2002 which was replaced in 2013 by EU directive 2013/34. In 2014, EU Directive 2014/56 an “Audit Directive” was passed. The UK has to transpose this into the UK law by 2016. The Audit Directive has two important points. First, an auditor has to express his opinion on the statement of compliance with legal requirements. Second, an auditor has to state whether any material mistake has been identified. The Financial Reporting Council (FRC), as a single independent entity, sets and enforces the accounting framework and judges the fair and true view of the financial statements that show the firm’s position, profit and loss.

In Kuwait, according to the 2010 Act, the Kuwaiti authority has the power to determine the kind of accounting standards which companies have to follow.¹¹³ According to rule No. 10/2011 the authority has adopted the International Financial Reporting Standards (IFRSs) issued by the International Accounting Standards Board (IASB). However, a number of experts in the accounting field criticised the application of international accounting standards, saying that it is difficult to comply with these rules because of

¹¹⁰ <[https://frc.org.uk/Our-Work/Publications/Accounting-and-Reporting-Policy/FRS-102-The-Financial-Reporting-Standard-appli-\(1\).pdf](https://frc.org.uk/Our-Work/Publications/Accounting-and-Reporting-Policy/FRS-102-The-Financial-Reporting-Standard-appli-(1).pdf)> accessed 3 February 2015.

¹¹¹ Companies Act 1947, s13 and s16; Companies Act 2006, s396(2) states that ‘the accounts must give a true and fair view’.

¹¹² <<http://www.icaew.com/en/library/subject-gateways/accounting-standards/knowledge-guide-to-international-accounting-standards>> accessed 3 February 2015.

¹¹³ Capital Market Law 2010, Article 68.

complexities. They recommended creating an independent body to help apply and supervise this complicated processes.¹¹⁴

Protecting investors requires good accounting legislation that is fairly presented and subject to professional judgement. There are three important points to cover. First, having good accounting reporting standards. The second point is having professional auditors that express their opinion and state any misstatement. The third requirement is having a single independent body to set and enforce accounting standards.

Although in Kuwait there is a clear indication of what is expected of companies in terms of financial reporting, it is difficult to measure their compliance because of the lack of a specific body to measure them. Kuwait needs to have a body responsible for developing the accounting standards and making firms comply, such as the Financial Reporting Council (FRC) in the UK.

2.7 Conclusion

This chapter has analysed the concept of protecting investors under securities laws and other laws. This chapter has considered four areas that are impacted by investor protection, namely the investors themselves, the securities, the securities laws and the mechanism of investor protection.

Firstly, this chapter has stated that investors can be individuals or institutions, both of which in turn can be local or foreign. Each of them needs to be protected in a special way. Individual investors are normal persons, who try to ensure a good future for themselves and their families by improving their standard of living, obtaining a good education for their children, and protecting the value of their savings. An individual investor in the UK is viewed as a consumer of financial products or services. In contrast, Kuwait has no definition of an individual investor.

¹¹⁴ <<http://www.alanba.com.kw/ar/economy-news/363546/26-02-2013>> accessed 3 February 2015.

Secondly, the chapter has discussed the approach to financial regulation. Three components that make up financial regulation have been identified and are referred to in the UK as micro- and macro-prudential regulation together with the regulation of the Conduct of Business. The role played by the UK's regulatory authority has been compared with the regulatory structure in Kuwait, especially with regard to the regulation of securities. In Kuwait, the Capital Market Authority is dedicated to the regulation of securities, while the Central Bank undertakes the regulation of everything else. In the UK, securities regulation is part of the overall financial regulation. Thirdly, this chapter has looked at the provisions contained in legislation not specifically targeted at securities, such as bribery law, company law, and accounting law, to illustrate how this form of 'hard law' protects investors.

Based on investors' expectations, protection needs to do three things. Firstly, it should guarantee a fair price that has not been influenced by market abuse, as discussed in Chapter Three. Secondly, it should ensure that investors have access to important information, as addressed in Chapter Four. Thirdly, investors should have protection from unscrupulous behaviour by managers, as discussed in Chapter Five. Finally, any regulation which tackles the above should be sound and effective and have the right balance of hard law and soft law. The next three chapters will address examples of laws that govern insider dealing, rule-making that governs fair disclosure and soft law that governs corporate governance. Chapter Six will focus on the way to develop laws, rule-making and codes by having a sound regulatory authority.

Chapter Three

Insider Dealing

3.1 Introduction

This chapter aims to answer the question about whether the 2010 Act protects investors from insider dealing. Professor Stephen M Bainbridge has described the issue of insider dealing as ‘one of the most controversial aspects of securities regulation, even among the law and economics community’.¹

There is no doubt that information is very important when buying or selling in the stock market, because information can materially affect the value of the securities. But, if access to information is limited to a group according to their positions, without which they cannot obtain the information, other investors will lose the opportunity to make a profit. Insider dealing adversely affects the opportunity that should be available to everyone in the market to have open access to information. This ‘principle of equality’ of having simultaneous information will be diminished.² Since investors depend on information to make good decisions at the right and appropriate time, it is clear that a problem arises when only some investors know the positive or negative information, which can lead to shortcomings in the principle of equal access.

¹Stephen Bainbridge, ‘Insider Trading’, in Stephen Bainbridge (ed) *Insider Trading* (Edward Elgar 2011) 700.

²Article 3 of Executive Regulations of Kuwaiti Law No. 7 of 2010 provides that ‘The Authority aims to:

1. Organise the securities business in line with the principles of equity, efficiency, competitiveness and transparency...’

Decisions on whether to buy or sell are based on information collected from the market. The problem arises, however, when the information comes from confidential sources, and only a few people have access to it. This leads to the violation and derogation of the fairness of the market because of the inequality created by their position or their relationship to the source of the information.

Promoting investor confidence in the securities markets and in particular ensuring that those participating in the markets do so on the same informational footing is one of the goals of the capital market worldwide. This goal cannot be achieved without regulating insider dealing. The existing legal framework for the regulation of insider dealing in Kuwait, Qatar and Saudi stock markets will be discussed in this chapter.

This chapter will focus on the historical developments of the securities law governing insider dealing in the USA, the UK, Qatar, Saudi and Kuwait. Enforcement of insider dealing will be dealt with in chapter six. Criminal law will not be considered unless it forms part of the securities regulation as is the case in some jurisdictions such as Kuwait.

3.2 Background to insider dealing

Insider dealing involves the use of information that is not disclosed to the public. Insider dealing is not a recent phenomenon. It has a long history, and most countries have a special way to combat and fight it. The United States is a clear example of this battle.

An increasing number of countries prohibit insider dealing by law. Even so, debate over the control of insider dealing has continued since the 1960s, and countries have different experiences with, and responses to, insider dealing. For example, the first judicial decision banning insider dealing was handed down in the United States in the case of *Re*

*Cady, Roberts & Co.*³ According to Sereczynska, insider dealing in France was prohibited in 1967.⁴ Kuwait has not been immune from insider dealing, as will be discussed later.

Nowadays, nearly every stock exchange market bans insider dealing, but they differ in the way they tackle it. Each of the two large competing markets, the European Union (EU) and the United States, has a different system for combating insider dealing. The EU recognises a breach of the duty of fairness to the market and other uninformed investors by using insider information obtained from a person in possession. It is beyond the scope of this thesis to study the EU position in detail; however, this thesis will look at the UK. The United States recognises insider dealing to be a violation of fiduciary duties or breaching a duty of confidence owed to the source of information, which will be discussed later.⁵

When considering insider dealing, it is helpful to focus on American law, because the United States has a long history and extensive experience in this regard.⁶ The United States, which is the home of the world's largest capital market, was one of the first jurisdictions to make insider trading illegal.⁷ There is a vast amount of information regarding the detection and prosecution of insider dealing under American law. Stephen Bainbridge said that 'prohibition of insider trading will reward study not only for USA corporate and securities law scholars, but those of all countries'.⁸ However, Bainbridge

³40 SEC 907 (1961). In *Cady, Roberts & Co.*, a board member had given important information about an imminent dividend cut in a firm to a stockbroker, as a result of which the broker sold the company's shares. In 1961, the Disclose or Abstain Rule was established by this case.

⁴Iwona Sereczynska, *Insider Dealing and Criminal Law; Dangerous Liaisons* (Springer 2012) 1

⁵ *ibid* 2.

⁶Stephen Bainbridge, *Insider* (n 1) 700.

⁷Stephen Bainbridge, *An Overview of Insider Trading Law and Policy: An introduction To the Insider Trading Research Handbook* 2013 2. <<http://ssrn.com/abstract=2141457>> accessed 7 December 2012.

⁸ *ibid* 2.

describes the modern American securities regulation as a complex, federally imposed ban of insider dealing and this is a central feature of the regulations.⁹

3.3 Definition of insider dealing

Generally, insider dealing involves trading (selling or buying) in a specific company's securities by a person linked to that company, who, by virtue of that link, has inside information that would change the securities' price if this information were made public knowledge.¹⁰ Such a person who possesses inside information could not achieve any profit from the trade if he or she did not have the link to the company.

Bainbridge defines insider dealing, generally speaking, as 'trading in securities while in possession of material non-public information'.¹¹ This can be illustrated by the following example. A director of a company, who learns of good or bad news during a board meeting, buys or sells the company's shares to profit from the undisclosed information before the information is disclosed to the public. Under such circumstances, the director is involved in insider dealing. In this example, the director is seeking to take advantage of his position inside a company. This is also an example of the misuse of confidential data. Insider dealing also includes the situation where a person with confidential information persuades another person to trade in the securities. Insider dealing also occurs when a person avoids a loss or gains a profit by misusing confidential information gained through the person's position within the company.¹²

It should be underlined that the key to passing effective legislation against insider dealing is to define it properly. The definition has to cover the following four areas: who

⁹ *ibid* 3.

¹⁰ Gill Brazier, *Insider Dealing: Law & Regulation* (Cavendish Publishing Limited 1996) 76.

¹¹ Stephen Bainbridge, *Insider* (n 1) 701.

¹² Barry Rider, Kern Alexander, Lisa Linklater, *Market Abuse and Insider Dealing* (Butterworths Compliance Series LexisNexis 2002) 4.

is an insider? What is the inside information? How is the inside information transferred? And what action is banned?

Who is an insider? In the past in the financial literature, ‘insiders’ were divided into two categories: primary insiders and secondary insiders. Primary insiders may hold such positions as members of the board of directors, managers, in-house accountants and in-house lawyers, among others. These people hold positions that enable them to obtain information through the company’s management or supervision. Alternatively, secondary insiders are those who receive information directly or indirectly with full knowledge of the importance of the inside information through primary insiders.¹³ This includes people who work with the company through their profession, such as external accountants and lawyers.

Some people argue that no distinction should be made between primary and secondary insiders. They offer several reasons to support their position. Firstly, they contend that the distinction is unnecessarily complicated, because it forces prosecutors and regulators to show not only that a person was in possession of inside information relating to a particular security, but that she or he obtained it in a particular manner. Secondly, the distinction fails to take into account how insider dealing is carried out. For example, few insider dealers deal themselves. Since there is nearly always a primary insider and a secondary accomplice, the distinction is not important. Finally, they argue that there is no justification for saying that a secondary insider (tippee) is less guilty than a primary insider.¹⁴

Nowadays, much of the legislation defines insiders differently in that it does not distinguish between primary and secondary insiders. For example, the UK defines an insider as any person who has inside information (he knows it is inside information)

¹³ Ahmed Almelhem, ‘The prohibition of company director from buying or selling the shares of the company during the term of his office’ (2011) 35 *Journal of Law, University of Kuwait* 461.

¹⁴ R C H Alexander, *Insider dealing and money laundering in the EU: Law and regulation* (Ashgate 2007) 230.

from an inside source (he knows that he has obtained it from an inside source) according to section 57 of the Criminal Justice Act (CJA) 1993.

What is inside information? Before defining inside information, the value of information in the financial market should be appreciated in order to understand insider dealing. Inside information includes the factors that determine the price of securities in the market.¹⁵

Broadly speaking, inside information is defined as unpublished correct information that may substantially affect the price of securities and that relates to such securities or to the source of information. The definition has four elements. First, the information must not have been previously published. This includes non-published information described as secret information, even if a number of people know this information, as long as they know that the information is confidential. It is not necessary that all people are familiar with the information in order for it to be published. It is enough if it becomes known by one or more persons who are interested in the information. Statistics and the analysis of the published data are not necessarily confidential information, even though they are unpublished. Secondly, the information should be precise in that it is comprised of correct data rather than mere rumours. The disclosure of rumours does not constitute insider dealing. The third element is that the information be material, which requires that its publication will affect the price of the securities to which it relates. Finally, the information must relate to securities or to their issuing company. Such information can be internal in nature, such as information that discloses the occurrence of high profits and rewards, or it can be external information, which discloses that another company has agreed to a merger with the issuing company.¹⁶

How is the information transferred? A person could obtain inside information from an inside source directly, such as being a director or through family relationship, for example, or indirectly via a family member to another person. In this respect, some laws

¹⁵ Brenda Hannigan, *Insider dealing* (2nd edn, Longman Group Ltd 1994) 2.

¹⁶ Ahmed Almelhem (n 13) 460.

require that, to be charged with insider dealing, the person should have obtained the information from inside sources. Typically If the person has not received the information from inside sources, he or she will not be convicted of any criminal offence or be subject to regulatory enforcement or attract any civil liability although this will depend on the jurisdictions.¹⁷

What actions are banned? There are two important points here: the first is the type of prohibited act, such as dealing with inside information, disclosing inside information or encouraging other persons to trade. The type of ban will depend on the legislation and will be discussed later. The second important point is the scope of prohibition in terms of who is banned namely, a company insider or an outsider who receives inside information. For example, the Kuwaiti legislature omits any mention of criminal responsibility for the third party (a tippee) because he is not considered an insider.¹⁸

3.4 Debate over insider dealing

Protecting market integrity and stability is the main aim for prohibiting insider trading. The entire nation suffers from insider dealing, not just special individual victims.¹⁹ Insiders have the potential to gain enormous profits. For instance, among many examples found in the United States, Ivan Boesky is one of the more well-known. Boesky paid a fine of \$50 million and an additional \$50 million in disgorged profits, a total of \$100 million,²⁰ and he received a prison sentence of 3.5 years²¹. The question here is, even after paying this amount of money in settlement, how much profit did he make from illegal insider dealing in 1991? How do those profits compare to the ill-gotten gains being realised through insider dealing today?

¹⁷ Barry Rider, Kern Alexander, Lisa Linklater (n 12) 6.

¹⁸ Adel Almane, 'Criminalization of insider dealing in capital market: Comparative study between Kuwaiti and French laws' (2012) Journal of Law, University of Kuwait.

¹⁹ R C H Alexander (n 14) 2.

²⁰ Brenda Hannigan (n 15) 1.

²¹ <http://en.wikipedia.org/wiki/Ivan_Boesky.> accessed 4 February 2015.

The question of why one should regulate insider dealing at all is not as odd as it might appear. Some have said that insider dealing is a victimless crime and that there is nothing fundamentally wrong with this activity, but the same could be argued about fraud.²² Identifying the victims of insider dealing presents an interesting issue. Some have said that the market suffers, but others have argued that this is too vague. In this situation, some laws have been enacted that criminalise conduct, such as treason, that affects the community at large but has no precise individual victims: the nation as a whole is the victim.²³ Until recently, some countries, such as the central and eastern European states and some of the developing countries, have looked at insider dealing as a version of corruption or as a kind of perk that accompanies holding certain positions.²⁴

There are two principal arguments for and against insider dealing, respectively. The argument in favour of insider dealing, known as the ‘Manne Argument’, is an economic argument, while the argument against insider dealing is based on moral principles. The idea that insider dealing should be regulated and banned prevails. Each side has its reasons, as will be discussed.

3.4.1 Manne argument²⁵

Professor Manne researched the issue of insider dealing extensively and proffered an economic argument for permitting it. His arguments are based on economic, not legal, considerations. He believes that there is nothing wrong with insider dealing.²⁶ Manne’s

²² Alexander (n 14) 1.

²³ *ibid* 2.

²⁴ *ibid*.

²⁵ Henry G Manne is one of the early exponents of the law and economics discipline. Professor Manne has published a number of books and articles, including recently ‘The Collected Works of Henry G. Manne’ in three volumes. <http://en.wikipedia.org/wiki/Henry_Manne> accessed 4 February 2015.

²⁶ Manne has also asserted that the SEC selected the wrong weapon to protect the market. ‘The SEC is presently in the process of shaping and developing another technique, more frightening and potentially more damaging than anything yet done. Instead of trying to discover the identity of inside traders after the

first argument is that insider dealing has the potential to encourage people to trade in the securities markets, since it focuses on corporate managers, who need the encouragement of a reward. Manne mentioned that managers need rewards for their performance and added that although they are remunerated for their managerial skills such remuneration is set in advance and cannot be used to distinguish between innovative and ordinary managers; therefore, it is inappropriate. He believed that nothing would motivate managers like market prices and that the greatest motivation is to become rich quickly through insider trading. Manne also believed that a bonus cannot reward a manager, because it does not depend upon individual contribution, but is instead based on the firm's profits.²⁷

Manne's contentions have generated a number of replies. First, the personal rewards of insider dealing do not make it advantageous to society. Otherwise, it would also be argued that the rewards of dealing in drugs are also advantageous to society. The second response to this argument is that those who hold these kinds of jobs, such as executives and managers, are already well-compensated by high salaries, bonuses, and other benefits. Another point is that Manne concentrated on corporate executives as though they are the only persons who might participate in insider dealing. He thereby disregarded other individuals who would benefit from insider dealing, such as the company lawyer and accountant, among others. Manne would offer them the same reward. The final reply to the first argument is that Manne failed to point out that there are two sides: a profit and a loss. He only referred to the situation when the company benefits from having a higher market value. In the contrary case, the executive might sell securities at a loss to benefit from insider dealing in a way that would cause other investors to suffer from the company's losses.²⁸

fact....the SEC has sought to prevent insider dealing by stopping all trading in a company's shares.' Henry Manne, 'In Defense of Insider Trading' in Stephen Bainbridge (ed), *Insider Trading*, Edward Elgar 2011) 42.

²⁷Henry Manne, *Insider Trading and the Stock Market* (The Free Press 1966) 131-136.

²⁸ Alexander (n 14) 3-5.

In the second argument, Manne claimed that without insider dealing there would be a large change in securities prices which is harmful to the stability of the market.²⁹ Manne emphasised that the whole market would benefit from insider dealing, because any rise or fall in securities prices that would result from such dealing would only gently increase or decrease the amount that would otherwise have resulted from the transaction. He explained that executives will buy securities at a lower price before the information becomes public so that, after the announcement, the securities will rise gradually. Since this process would benefit the market as whole, it could enhance the stability of the markets. Opponents of the Manne view argue that only a small fraction of all those trading in securities are involved in insider dealing. In addition, insider dealing occurs in a very small percentage of all of the securities transactions, as a result of which it is not significant.³⁰

3.4.2 Moral principles argument

Fairness and equity are the strongest reasons for banning insider dealing, not the economic arguments that are still advanced today. The idea that insider dealing should be regulated and banned prevails.³¹

3.4.2.1 Unfairness and harm

The most popular moral argument against insider dealing is that it is simply unfair. An insider can rely upon information known only to him because of his position to decide whether and when to sell or buy securities. This is unfair. It is also unfair that the insider deals with people who do not have the same information as he does. So, the question here is whether it is unfair to enter into a securities transaction when an inequality of knowledge exists.³²

²⁹ Henry Manne, *In Defense of Insider Trading* (n 26) 421.

³⁰ Alexander (n 14) 6.

³¹ Stephen Bainbridge, *Insider* (n 1) 700.

³² *ibid* 52.

The strongest ethical objection is that insider dealing takes advantage of better data than other investors have, because they do not have and cannot get the same information that the insider possesses. However, some argue that it is illogical to expect that each transaction should be based upon an equality of knowledge in order to describe it as fair. In addition, no one can have and comprehend all available information. By analogy, a doctor cannot be blamed for charging the patient more money because the doctor has specialised knowledge.³³ Others point out that knowledge is the key to power.

The second area of concern is identifying the harm and the victim. The possible victims are as follows. 1) The market: some contend that the assertion that the victim of insider dealing is the market or society is made only because it is not possible to show that harm has actually been caused or to identify who has been harmed.³⁴ 2) Other investors: some contend that small investors are harmed by insider dealing, because they will be deterred from investing their savings in the market. Others counter that if the small investors are harmed because they lack knowledge about financial instruments, banning insider dealing will not increase their knowledge and, therefore, will not prevent them from suffering harm from insider dealing.³⁵ 3) Employers: some argue that employers' information should be protected within the contract of employment with the insider and one should not rely on public law (as securities law) to protect the employer's interests. This avoids any ethical debate on whether insider dealing should be regulated or not.³⁶ 4) Insiders: proponents of insider dealing contend that insiders are harmed by this ban, because they are compelled not to use their knowledge even though insider dealing does not harm any person.³⁷

3.4.2.2 Fraud

³³ibid.

³⁴ibid 54.

³⁵ibid 56.

³⁶ibid 57.

³⁷ibid 57.

As the insider does not disclose all of the information that he or she possesses to the person with whom he or she is dealing, some say that insider dealing is a kind of fraud. Proponents of insider dealing counter that there is no moral duty to disclose and explain all of the information that the insider has.³⁸ A practical example of a fraudulent action is the following scenario. An investor buys shares at a certain price from insiders before negative information is published. The insider is aware of the information, but does not disclose it. After the publication of the information the price drops. As a result, the insider has made money at the expense of the investor. Some would argue that the investor will buy anyway. But he would not buy at the same price if the information were published.

In the UK, the court of appeal in *McQuoid* case agreed to consider insider dealing as a type of fraud by saying ‘the message must be clear, when it is done deliberately insider dealing is a species of fraud, it is cheating’.³⁹

From a different viewpoint, insider dealing can be considered as fraud because the insider trades are based on an employer’s information, especially when the employer has trusted him to take care of it. In this situation, the insider misappropriates information belonging to his employer by breaching a fiduciary duty. However, the insider does not have a fiduciary duty to a trader. The misappropriation theory mentions that the insider breaches the confidential duty owed to the source of the data if he trades based on the employer’s information. This will be discussed in detail later.

3.4.2.3 Easy Money

Opponents of insider dealing assert that, because an insider can easily realise a significant amount of money in a short period of time with little or no effort, insider dealing is like theft. Proponents of insider dealing reject this assertion, because anyone can work hard enough to become fully informed and be successful without insider

³⁸ibid 58.

³⁹ *R. v McQuoid* [2009] EWCA Crim 1301 ; [2009] 4 All E.R 388 at [9].

information. They consider that opponents of insider dealing are really motivated by envy, which is not a good reason for any law.⁴⁰

Today, it is generally acknowledged that insider dealing is wrong and the argument about whether insider dealing should be regulated is purely of historical interest and is no longer an issue.⁴¹ The challenge now is to find the ideal model to combat insider dealing. What follows will consider the USA and the UK models for combating insider dealing. .

3.5 Developments in the United States against insider dealing⁴²

In the USA, there is a complicated regulatory structure that regulates the securities industry. There are federal and state laws.⁴³ The top regulatory agency is the Securities and Exchange Commission (SEC) which has to oversee all stock exchanges and anybody connected with trading securities. In 2007 the Financial Industry Regulation Authority (FINRA) was created. FINRA is a self-regulatory organisation which is responsible for policing the securities industry. It also sets rules for stockbrokers and licenses them and they can fine individual and firms. FINRA can handle customer complaints about any illegal or unethical actions. In terms of laws, individual states also have securities divisions.⁴⁴ They are different from state to state. It can be said that in the USA there is a multi fractioned regulatory system that includes federal and state bodies. This system is not suitable for Kuwait because it does not have a federal legal system.

The following section discusses the Pre-Securities Exchange Commission (SEC) rules, the SEC Era, the Disclose or Abstain Rule, Rule 14e-3, Misappropriation and Tipping.

⁴⁰ *ibid* 59.

⁴¹ Alexander (n 14) 229.

⁴² The phrase ‘insider dealing’ is referred to in the United States as ‘insider trading’.

⁴³ <<http://stocks.about.com/od/tradingbasics/a/Regulat011705.htm>> accessed 16 Nov. 15

⁴⁴ *ibid*

3.5.1 Pre-Securities Exchange Commission (SEC)

Before the introduction of specific laws to regulate insider dealing in 1933-34, attempts were made to apply the common law of fraud in all circumstances, although this did not always work because of the special nature of securities fraud. Three approaches were used by the state courts to impose criminal liability on insiders.

The 'Minority Rule' was adopted by a minority of states. According to this rule, an insider had to disclose inside information to selling shareholders before dealing with them. The majority of states adopted the 'Majority Rule,' whereby insiders did not have a fiduciary duty to shareholders, because, unlike trust law, they were not strictly trustees of the company. Although an insider had a duty of good faith and undivided loyalty to the company, the courts held that it was illogical to treat an insider as a trustee.⁴⁵ The Majority Rule did not prevent liability arising for misrepresentation or concealment of facts material to the purchase.⁴⁶ The third approach came about as an exception to the Majority Rule and was known as the 'special circumstances rule'. It means that the insider has to disclose to selling or buying shareholders before dealing with them the special facts that he knows about a company's activities that may or will soon have a material effect and that are not available in books or financial reports about the company. This rule is similar to the Minority Rule.⁴⁷ An attempt to conceal the purchaser's identity was also classified as special circumstances.

3.5.2 The SEC Era

Under American Federal law, four rules have evolved over the years in an effort to combat insider dealing. Two of these rules were created by courts according to section

⁴⁵ Michael Conant, 'Duties of Disclosure of Corporate Insider Who Purchases Shares' in Stephen Bainbridge (ed), *Insider Trading* (Edward Elgar 2011) 5.

⁴⁶ <<http://www.sechistorical.org/museum/galleries/it/index.php>> accessed 1 December 2012.

⁴⁷ Michael Conant (n 45) 9.

10(b)⁴⁸ of the Securities Exchange Act 1934 and Rule 10b-5.⁴⁹ Section 10(b) and Rule 10b-5 were fraud provisions. Neither mentioned insider dealing. However the anti-fraud provisions were relatively easy to apply to a corporate insider who secretly traded in his own company's shares while in the possession of inside information. What was unclear was whether 10b and 10b-5 prohibited insider dealing by a corporate outsider. In 1961, in *Re Cady, Robert & Co.*⁵⁰ the SEC stated in an administrative decision that they did based on the provision of 10b-5 which was known as the Disclose or Abstain Rule.

3.5.2.1 The Disclose or Abstain Rule

⁴⁸ Section 10(b) of the Securities Exchange Act 1934 renders it illegal:

To use or employ, in connection with the purchase or sale of any security registered on a national securities exchange or any security not so registered, or any securities-based swap agreement (as defined in section 206B of the Gramm-Leach-Bliley Act), any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors.

⁴⁹ Rule 10b-5, promulgated in 1942 under the Rules and Regulations pursuant to the Securities Exchange Act 1934, provides:

It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce, or of the mails or of any facility of any national securities exchange,

- a- To employ any device, scheme, or artifice to defraud,
- b- To make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or
- c- To engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person, in connection with the purchase or sale of any security.

⁵⁰40 SEC 907 (1961).

The Disclose or Abstain Rule states that ‘the people who have access to material non-public information should either disclose the information or abstain from trading that security’.⁵¹ This rule is also known as the ‘equal access theory’ or “Traditional Theory”.

Until the 1980s, cases on insider dealing were brought on the basis of the so-called traditional theory based on the disclose or abstain rule. However, at the start of the 1980s the SEC brought a case against an outsider, a printer called Chiarella⁵² publishing tender information. Chiarella was convicted of violating rule 10b-5 by trading on the basis of material non-public information. He did not owe a duty to shareholders of the trading corporation or have any relationship at all to those shareholders.

The United States Supreme Court overturned the conviction which had been based on the policy of equality of access to information stating that there can be no liability unless and until a person has a duty to disclose material information to a person with whom he or she is trading. In *Dirks v SEC*.⁵³ The supreme court also rejected the insider’s legal obligation stating that a tip was not sufficient to create liability and one needed to look at the motive of the insider and whether he personally benefited directly or indirectly from his disclosure. These cases narrowed the scope of the Disclose or Abstain Rule by requiring a fiduciary duty that excludes the outsider. In the two cases the Supreme Court would not apply the Disclose or Abstain Rule due to the fact that the people in the case did not have a fiduciary duty to the shareholders. However, there are

⁵¹ Henry Cheeseman, *Business Law: Legal Environment, Online Commerce, Business Ethics and International Issues* (8th edn, Pearson Education 2013) 701.

⁵²445 US 222 (1980), Vincent Chiarella got the names of the tender offer target companies from his job in a printing company. The information was in documents that had been given to him for printing. Based on this information, he made transactions sales or purchases and was prosecuted in a criminal court for insider dealing.

⁵³463 US 646 (1983), some facts in *Dirks v SEC* include fraud by a firm that was discovered by a financial analyst, who then informed *The Wall Street Journal*. When the *Journal* disregarded the information, the analyst passed the information to his clients to sell their stocks.

two essential ways in which the rule could cover the outsiders of a company. In these situations, a breach of fiduciary duty must also be found in order to apply this rule.⁵⁴

The first group of nominal outsiders to whom this rule can be applied are those who have a sufficiently close relationship with the issuer of the affected securities, and therefore they are a ‘constructive insider’⁵⁵. The three following conditions must be satisfied. The first occurs when the issuer gives the material non-public information to the outsider. The second occurs when the outsider is expected by the issuer to keep the information confidential. Finally, the relationship between the parties must be implied by such a duty. If any of these three conditions is not met, the rule does not apply. The second group of outsiders to whom this rule can be applied are those who obtain the information from a true or constructive insider.

The loophole in the law at that stage whereby outsiders could not be liable for insider dealing was filled by Rule 14e-3 and the misappropriation theory.⁵⁶

3.5.2.2 Rule 14e-3

In the wake of *Chiarella* the SEC passed Rule 14e-3 to remove the *Chiarella* duty requirement. The application of this rule does not require a breach of any fiduciary duty. According to Rule 14e-3, any person who is in possession of non-public information about a tender offer⁵⁷ that the person knows has come from an insider is banned from revealing the non-public information to any person who can trade based on

⁵⁴ Stephen Bainbridge, *Insider* (n 1) 702.

⁵⁵ *ibid.*

⁵⁶ *ibid.*

⁵⁷ A tender offer is a type of public takeover bid when by shareholders of the company are invited by a prospective buyer to tender their shares for sale at specified price during a specified time.

<https://en.wikipedia.org/wiki/Tender_offer> accessed 22 June 2015.

this information. However, the scope of the ban's application is very narrow in that it is limited to tender offers. Another consideration that may limit the scope of the application of this rule is the extent to which the offeror has started or has taken substantial steps toward the commencement of the offer.

Rule 14e-3 combats the improper use of inside information related to a tender offer. There remain gaps in the extent of the protection of the use of inside information for which additional rules are required. The sanctions for breach of these rules are regulatory and are enforced by the SEC.

3.5.2.3 Misappropriation

The misappropriation theory or rule is another part of American law governing insider dealing. The misappropriation theory means that a person who uses confidential information belonging to his employer to buy or sell securities breaches the duty owed to the source of the data. Such a person infringes a duty of confidentiality and loyalty. Generally, the theory relates to using the information belonging to his principal regardless of the fact that the person has no fiduciary duty regarding with whom he trades. The misappropriation theory says that insider dealing is part of a 'deceptive device or contrivance' (included in Section 10b). That is, the misappropriation theory is linked to insider dealing by section 10(b).⁵⁸

The misappropriation theory was born when Chief Justice Burger who dissented in *Chiarella* case argued that although *Chiarella* was not bound by confidentiality to investors with whom he traded he did owe a duty of confidentiality to his employers and thereby to bidders. By misappropriating information which had been entrusted to his employers he had breached his duty sufficiently to justify imposing rule 10b5 liability. Although the *Chiarella* case failed, this theory was subsequently adopted by the Second Circuit court of appeal as a basis for insider trading liability in the US in *US v*

⁵⁸ Stephen Bainbridge, *An Overview* (n 7) 11.

*Newman*⁵⁹ and others. However, it took another 10 years before the supreme court in 1997 would affirm in that this theory valid for apply rule 10b5.

The United States Supreme Court accepted the theory as legally binding in *US v O'Hagan*⁶⁰. In July 1988, James O'Hagan worked as a partner in the Minneapolis law firm Dorsey & Whitney, which was retained by Grand Metropolitan PLC (Grand Met) relating to its plan to take over the Pillsbury Company. Through his position at the firm, O'Hagan obtained non-public material information upon which he relied in buying Pillsbury shares and call options. The most important point here was that O'Hagan did not work with any of the parties to the tender offer and, as a result, did not breach a fiduciary duty. After approximately four months, Grand Met declared its tender offer, at which time O'Hagan sold shares and made a huge profit of more than \$4.3 million, which resulted from an approximately \$60 per share price increase in Pillsbury's stock. The Supreme Court confirmed his criminal conviction and applied the theory of misappropriation to protect the integrity of the stock exchange from abuse by an outsider, who owed no duty to the company's shareholders or fiduciary duty to the company. The Court affirmed O'Hagan's conviction on the charge that he violated section 10(b) of the 1934 Act and Rule 14e-3 by dealing with misappropriated non-public information and on the charge that he violated Rule 14e-3 by trading while in possession of non-public information relating to a tender offer.⁶¹

In conclusion, the misappropriation theory means simply that any person who deals in any shares on the basis of his or her employer's information will be guilty of insider trading.

⁵⁹ 664 F 2d 12 (2nd Cir 1981).

⁶⁰ 117 S Ct 2199, 2211 (1997).

⁶¹ Stephen Bainbridge, *Insider* (n 1) 704.

3.5.2.4 Tipping

The original fraud provision of 10(b) and 10b-5 which applied to a tippee was extended in common law in *Dirks v SEC* to include tippees. According to *Dirks v SEC*, two important conditions must be met to hold liable someone who receives confidential information (tippee). The first condition, relating to insiders (tipplers), is that insiders breach a fiduciary duty by giving a tip to a tippee. The second condition, relating to a tippee, is that a tippee must know or have reason to know about the breach of a fiduciary duty (the first condition).⁶²

In the *Dirks* case, simply breaching a duty was not sufficient; the duty of loyalty had to be breached by profiting from information entrusted to the tipper. In addition, some scholars said that the directors or other insiders had to benefit from the disclosure.⁶³ Consequently, while it may be careless to discuss business in a public place, it does not constitute a breach of loyalty.⁶⁴

As an example of illegal tipping, Gen Tek Inc CEO, William E Redmond tipped his close friend, Stefano Signorastrri the manager of Manhattan restaurant, with confidential information about the company which enabled the latter to make \$164,000 in illicit trading profits. Both agreed to pay more than \$324,000 to settle the SEC's charges related to dealing in Gen Tek Inc shares. The CEO also agreed to be barred from acting as an officer or director of a public company for five years.⁶⁵

This is a serious problem in Kuwait, because Kuwait is a small country and it is difficult to keep anything secret.

⁶² *ibid* 9.

⁶³ *ibid*.

⁶⁴ *ibid* 16.

⁶⁵ <<http://www.sec.gov/News/PressRelease/Detail/PressRelease/1370543516329#.VONAwNIcTIU>> accessed 17 February 2015.

3.5.2.5 Rule 10b5-1 and rule 10b5-2 in 2000

Despite the courts' adoption of the misappropriation theory, there still remained unresolved issues. In a number of cases the Supreme Court described the insider violation as trading 'on the basis of material non-public information' but it did not address the issue of use versus possession. Three Court of Appeal cases reached different conclusions. In *United States v Teicher*⁶⁶ it ruled that 'knowing possession' is sufficient, in *SEC v Adler*⁶⁷ it ruled 'use is required, but proof of possession provides strong inference of use and in *United States v Smith*⁶⁸ it required that 'use' be proven in a criminal case.⁶⁹ Another unresolved issue that came to light in *United States v Chessman*⁷⁰ concerned the duty of trust or confidence in non-business relationships such as family and other personal relationships.

This was unsatisfactory from the SEC's point of view. One of the major responsibilities of the SEC is to promulgate regulations and rules that have the force of law and that help to achieve the aim of the Federal Securities Act.⁷¹ Pursuant to that responsibility, the SEC promulgated rules 10b5-1 and 10b5-2 to attempt to resolve the two issues mentioned above.⁷² Part (A)⁷³ of the former rule consisted of a general rule formalising

⁶⁶ 987 F 2d 112, 120-21 (2d Cir) cert denied, 510 US 976 (1993).

⁶⁷ 137 F 3d 1325, 1337 (11th Cir 1998).

⁶⁸ 155 F 3d 1051, 1069 & n 27 (9th Cir 1998), cert denied, 525 US 1071 (1999).

⁶⁹ <http://www.sec.gov/rules/final/33-7881.htm#P233_90511> accessed 14 March 2013.

⁷⁰ 947 F 2d 551 (2d Cir 1991); the Second Circuit said that 'marriage does not, without more, create a fiduciary duty'.

⁷¹ Henry Chessman (n 51).

⁷² <<http://www.sec.gov/rules/final/33-7881.htm>> accessed 12 March 2013.

⁷³

(A) *General*. The 'manipulative and deceptive devices' prohibited by Section 10(b) of the Act (15 U.S.C. 78j) and § 240.10b-5 there under include, among other things, the purchase or sale of a security of any issuer, on the basis of material non-public information about that security or issuer, in breach of a duty of trust or confidence that

the decision in *O'Hagan* while (b) introduced a definition of 'on the basis of' material non-public information as being aware of material non-public information when making a purchase or sale. In addition, the rule adds affirmative defences, which means that insiders can in certain circumstances be exempt from liability for insider trading, such as when the insiders had had a commitment contract for trading or a written trading plan before being aware of the inside information. Rule 10b5-2 provides three non-exclusive situations in which a person is deemed to have a trust or confidence duty.⁷⁴

In the United States, three sources of law have contributed to the development of the insider trading regime: the 1934 Act (statute), the courts (common law), and the rules promulgated by the SEC. Each of the three sources has affected the insider trading regime over time, starting in 1934 and most recently in 2000, as shown below.⁷⁵

is owed directly, indirectly, or derivatively, to the issuer of that security or the shareholders of that issuer, or to any other person who is the source of the material non-public information.

⁷⁴ For purposes of this section, a 'duty of trust or confidence' exists in the following circumstances, among others:

Whenever a person agrees to maintain information in confidence... Whenever the person communicating the material non-public information and the person to whom it is communicated have a history, pattern, or practice of sharing confidences... Whenever a person receives or obtains material non-public information from his or her spouse, parent, child, or sibling.

⁷⁵ <http://www.sechistorical.org/museum/galleries/it/takeCommand_d.php> accessed 19 Nov. 2015

Year	Event	Important points
1934	<ol style="list-style-type: none"> 1- The Securities Exchange Act 1934 was enacted. 2- SEC Established. 	<ol style="list-style-type: none"> 1- There is no specific provision banning insider trading directly. 2- Section 10b makes it illegal ‘to use or employ... any manipulative or deceptive device or contrivance...’
1942	SEC promulgates Rule 10b-5	To enforce section 10b above.
1961	<i>Re Cady, Roberts & Co.</i> ⁷⁶	<ol style="list-style-type: none"> 1- The first case in which a court banned insider trading under section 10b and rule 10b-5. 2- Adopted the ‘Disclose or Abstain’ Rule (needed a breach of a fiduciary duty).
1980	<i>Chiarella v United States</i> ⁷⁷	<ol style="list-style-type: none"> 1- US Supreme Court narrowed the scope of the ‘Disclose or Abstain’ Rule. 2- Adopted rule 14e-3 regarding tender offer.
1984	<i>Dirks v SEC</i> ⁷⁸	<ol style="list-style-type: none"> 1- Adopting tippee and tipper liability. 2- In <i>Dirks</i>, the tippees were not liable, because the tipper did not personally benefit from the disclosure.
1997	<i>United States v O’Hagan</i> ⁷⁹	<ol style="list-style-type: none"> 1- Adopted the ‘misappropriation’ theory (needed a breach of a duty of trust or confidence). 2- Extended the scope of the ban to include ‘outsiders’.
1998 - 1999	<i>United States v Teicher</i> ⁸⁰ <i>SEC v Adler</i> ⁸¹ <i>United States v Smith</i> ⁸²	Three Court of Appeal cases reached different conclusions
2000	SEC promulgated rules 10b5-1	Resolved two issues

⁷⁶ 40 SEC 907 (1961).

⁷⁷ 445 US 222 (1980).

⁷⁸ 463 US 646 (1983).

⁷⁹ 117 S Ct 2199, 2211 (1997).

⁸⁰ 987 F 2d 112, 120-21 (2d Cir) cert denied, 510 US 976 (1993).

⁸¹ 137 F 3d 1325, 1337 (11th Cir 1998).

⁸² 155 F 3d 1051, 1069 & n 27 (9th Cir 1998), cert denied, 525 US 1071 (1999).

	and rules 10b5-2	<ol style="list-style-type: none"> 1- Whether possession of inside information was enough or whether it had to be used. 2- When a duty of trust or confidence exists for the purpose of the misappropriation theory. For example, family members.
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Table 3.1 Milestones in the Development of Insider Trading in the USA

3.6 Developments in the United Kingdom against insider dealing

The UK has not faced the problem of the USA arising from the presence of legislation at state level and at federal level. Moreover, the UK legislated specifically against insider dealing from the outset unlike the USA where for nearly half a century. There was reliance on case law and secondary legislation in the form of rules.⁸³ With the arrival of the EU, UK law was expanded. The range of actionable insider dealing activities was increased under the term market abuse which also comprised actionable activities other than insider dealing.

The following discusses the evolution of financial regulation related to insider dealing.

3.6.1 1980 - 1993

Before 1980, prohibiting insider dealing was limited to requiring company directors and their families to report their trading in shares of their own companies.⁸⁴ According to

⁸³ It is difficult to compare the insider dealing laws of the United States and the United Kingdom, because the situation in the United States is and has been complicated by the evolution of many theories over time and by the complicated manner in which the American legal system addresses insider dealing (common law, statutes and SEC rules). However, in the United Kingdom, a fiduciary duty does not have to be breached, and insider dealing is defined more clearly than in the United States.

⁸⁴ Kern Alexander, 'UK Insider and Market Abuse Law: Strengthening Regulatory Law to Combat Market Misconduct' in Stephen Bainbridge (ed), *Research Handbook on Insider Trading* (Edward Elgar 2013) 410.

Clarke, insider dealing first became a crime in the UK in 1980 in limited circumstances under the Companies Act 1980.⁸⁵

Legislation to regulate insider dealing in a wider way in the UK was first introduced in 1993 with the promulgation of the Criminal Justice Act (CJA), which made insider dealing a criminal offence punishable with an unlimited fine or imprisonment not exceeding seven years or both.⁸⁶

3.6.2 2000

The UK government felt that the 1993 Act, particularly relating to insider dealing, did not adequately address all forms of abusive conduct. Thus, it introduced the Financial Services and Markets Act 2000 (FSMA) in order to extend the scope of the law and to make it possible to take civil action to complement the criminal law, because the latter required a standard of proof which made it difficult to effectively police the UK markets. In 2005, the Act was amended to implement the European Union Market Abuse Directive 2003/6/EC. In accordance with the directive Section 118 of the 2000 Act, extended the types of market abuse to seven from the original three, including insider dealing. UK legislation on insider dealing and market abuse is based on European Union Market Abuse Directive 2003/6/EC.

In the United Kingdom, criminal lawsuits and civil sanctions for insider dealing offences are brought by the Financial Services Authority (FSA) (now FCA). Few criminal prosecutions have been pursued, because the standard of proof required to convict is higher than in civil actions. The criminal standard must show culpability beyond reasonable doubt, which is not easy to do with the type of evidence in such cases, because ‘insiders’ have many ways of concealing their tracks, including the use

⁸⁵ Sarah Clarke, *Insider Dealing: Law and Practice* (OUP 2013) 22.

⁸⁶ CJA 1993 s61.

of nominees, offshore companies and the like. Even if the evidence is uncovered, it must be corroborated, which is also difficult. The prosecution needs to establish that:

- An individual possessed inside information.
- He or she knew that such information was inside information.
- An individual traded in such inside information.
- The individual traded knowing that such information had come from an inside source.

In the majority of cases, there will be no direct evidence that a person possessed inside information. In the case of *R v Holyoak, Hill and Morl* (unreported),⁸⁷ the prosecution failed to prove that when the defendants traded in the shares of a takeover target, the information that the defendants held was price-sensitive inside information. The defendants effectively disputed the charge by establishing that they thought that the information upon which they relied in their dealings had been publicly disclosed.

On the other hand, in the case of *R v (1) McQuoid (2) Melbourne*,⁸⁸ the prosecution was successful. The jury found that Melbourne had received inside information from McQuoid, in reliance upon which Melbourne made a profit. The court ordered the FSA (now FCA) to freeze the profit and sentenced each defendant to eight months in prison.

The 2008 financial crisis in the UK has led the FSA (now FCA) to prosecute more criminal cases in an effort to deter insiders. This policy of ‘credible deterrence’ has paid dividends with six successful prosecutions between 2009 and 2011.⁸⁹ Between there and now there have been 27 convictions.⁹⁰ The FSA (now FCA) uses its power of

⁸⁷ An account of the case is given by Jane Mayfield in an article entitled ‘The FSA’s approach to insider dealing’ [2009] 159 NLJ 7373.

⁸⁸ (2009) Southwark Crown Court. After the buying process on 1 June, the price jumped to 45 pence per share after the takeover offer was announced. Melbourne earned approximately £48,900. Three months later, he gave half of the money that he had made from the deal to McQuoid.

⁸⁹ Iain Macneil, *An Introduction to The Law on Financial Investment* (2nd edn, Hart Publishing Ltd) 414.

⁹⁰ <<http://www.fca.org.uk/news/three-charged-with-insider-dealing>> accessed 19 June 2015

investigation provided by the FSMA 2000 to achieve this success, present evidence and prosecute insider dealing as defined in the CJA 1993.⁹¹ It is beyond the scope of this thesis to study methods of proof and investigation.

3.6.3 2005

The EU have expanded the regime to cover different types of market abuse not just insider dealing which is different from some other jurisdictions which have specific provisions for insider dealing.⁹² The EU market abuse regime is mostly based on Market Abuse Directive (The 2003 MAD)⁹³. In 2014 new directives repealed the 2003 directive.⁹⁴

Undeniably, insider dealing is a form of market abuse. How the legislation defines market abuse depends on the jurisdiction. For example, in Kuwait there is no legal definition of market abuse. On the other hand, in the UK the FSMA 2000⁹⁵ defines

⁹¹ Jane Mayfield (n 87).

⁹² Niamh Moloney, *EU Securities And Financial Markets Regulation* (3rd end, Oxford University Press 2014) 699.

⁹³ In terms of European law, the so-called Segre Report in 1966 contained the first proposal to standardise insider dealing and said that the problem could arise only in securities from directors or executives in their own companies. The next step occurred in 1989, when the vast majority of the member states had no insider dealing regulations. The battle against insider dealing started with the adoption of Council Directive (89/592/EEC) of November, 1989, which coordinated regulations on insider dealing. In addition, the introduction of insider dealing prohibition in all member states was the most important objective. Following the previously mentioned Directive, in 2003, a new Market Abuse Directive (MAD) was passed, which has a much broader range of application than the previous Directive. Iwona Seredynska, *Insider Dealing and Criminal Law; Dangerous Liaisons* (Springer 2012) 3-4

⁹⁴ *ibid.*

⁹⁵ The seven types of behaviour that constitute a form of market abuse fall within 'market abuse' as that term is defined by the British Parliament in direction-driven amendments to the Financial Services and Markets Act 2000 (FSMA), Section 118 changed the statutory definition of market abuse in Part VII Control of Business Transfers:s118 Market abuse.

seven types of market abuse contained in the EU 2003 directive and is probably the most comprehensive definition of this activity. This is in addition to the definition of insider dealing in the 1993 Act.

The UK has a dual criminal and civil regime for insider dealing.⁹⁶ Thus, the FCA has two options to follow. First, under the CJA it may prosecute an insider dealer through the courts. This can lead to prison. The second option is under the market abuse regime, which can lead to an unlimited fine. This is effected without going to court, through the FCA discipline committee.

The first three forms of market abuse are considered to be types of insider dealing.⁹⁷ These three types of market abuse are defined in the 2000 Act as follows:

The first type is defined as follows: ‘(2) The first type of behaviour is where an insider deals, or attempts to deal, in a qualifying investment or related investment on the basis of inside information relating to the investment in question’. This type of abuse can be described as insider dealing.

The second type of market abuse is defined as follows: ‘(3) the second is where an insider discloses inside information to another person otherwise than in the proper

(1) For the purposes of this Act, market abuse is behaviour (whether by one person alone or by two or more persons jointly or in concert) which— (a) occurs in relation to (i) qualifying investments admitted to trading on a prescribed market, (ii) qualifying investments in respect of which a request for admission to trading on such a market has been made, or (iii) in the case of subsections (2) or (3) behaviour, investments which are related investments in relation to such qualifying investments, and (b) falls within any one or more of the types of behaviour set out in subsections (2) to (8).

⁹⁶ Marten Hopper, ‘Overview of Market Conduct Regulation in the UK’ in Martin Hopper and others (eds) *A Practitioner’s Guide to the Law and Regulation of Market Abuse* (Sweet & Maxwell 2013) 10 - 11.

⁹⁷ *ibid* 11.

course of the exercise of his employment, profession or duties'. This type of abuse can be described as the wrongful disclosure of inside information.

The third type of behaviour is defined as follows:

(4) The third is where the behaviour (not falling within subsection (2) or (3) (a) is based on information, which is not generally available to those using the market, but which, if available to a regular user of the market, would be, or would be likely to be, regarded by him as relevant when deciding the terms on which transactions in qualifying investments should be effected, and (b) is likely to be regarded by a regular user of the market as a failure on the part of the person concerned to observe the standard of behaviour reasonably expected of a person in his position in relation to the market.

This type of abuse can be described as the wrongful use of inside information.

As can be seen from the foregoing, market abuse is defined very broadly to cover market and off-market behaviour.⁹⁸ Market abuse can be committed by one person or more and according to the 2000 Act it is likely to be flexible.⁹⁹

Market abuse has a destructive influence on the securities market and damages the integrity of the market.¹⁰⁰ An example of market abuse action can be seen from the FSA (now FCA) enforcement decision against Andrew Osborne, who worked as a broker at Merrill Lynch International.¹⁰¹ He engaged in serious market abuse and was fined £350,000 because he failed in his duty not to disclose inside information to one of his customers in 2009. The customer avoided losses of around £5.8 million as a result of having inside information. The former FSA (now FCA) Director of Enforcement and Financial Crime, Tracey McDermott, stated: 'There should be no doubt about the FSA's

⁹⁸ Barry Rider and Kern Alexander, *Market Abuse and Insider Dealing* (2nd edn, Tottol 2009) 78.

⁹⁹ Edward Swan and John Virgo, *Market Abuse Regulation* (2nd edn, OUP 2010) 215.

¹⁰⁰ This idea is supported by Article 2 of Directive 2003/6/EC of the European Parliament and of the Council of 28 January 2003 on insider dealing and market manipulation (market abuse). '(2) An integrated and efficient financial market requires market integrity. The smooth functioning of securities markets and public confidence in markets are prerequisites for economic growth and wealth. Market abuse harms the integrity of financial markets and public confidence in securities and derivatives.'

¹⁰¹ <<http://www.fsac.org.uk/library/communication/pr/2012/014.html>> accessed 22 June 2015

commitment to take tough action where approved persons fail in their responsibilities'.¹⁰²

UK law is set to change again in 2016 as a result of two new market abuse directives created in 2014 which replace the previous directive. . The first one is the directive No. 596/214 (Regulation No.596/2014 the European Parliament and of the Council of 16 April 2014 on Market Abuse (Market Abuse Regulation) and repealing Directive 2003/6/EC of the European Parliament and the Council Commission Directives 2003/124/EU, 2003/125/EC, 2004/72/EC) was replaced the previous directive relating to market abuse, As a result, of market and technological development has changed the financial landscape according to part 3 of the directive. The second one is directive No. 2014/57/EC on the European Parliament and of the Council of 16 April 2014 on Criminal Sanctions for Market Abuse. These directives mention that market abuse harms the integrity of financial markets and public confidence in securities. Part 2 of the same directive states that the sanctioning regime in EU states is weak and a new legislative act is needed to make criminal sanctions available. Part 3 of the directive also mentions that administrative sanctions are insufficient to ensure compliance with rules on preventing and fighting market abuse. The UK has to apply the new directive from 3 July 2016. Both directives will not have a big effect on the UK regulations because the UK already criminal sanctions for serious types of offences s such as insider dealing, manipulation and unlawful disclosure according to section 118 of the Financial Services and Markets Act 2000, the Financial Services Act 2012 and the Criminal Justice Act (CJA) 1993.¹⁰³

The table below shows the milestones in the Development of insider dealing in the UK.

¹⁰² FSA/PN/104/2012 an enforcement decision was taken by the FSA.

¹⁰³ <<http://www.twobirds.com/~media/PDFs/News/Articles/2014/Compliance%20officer%20bulletin%20-%20market%20abuse.pdf>> accessed 6 October 2015

Year	Event	Important Points
Before 1993	Limited prohibition	-Directors and their family have to report trading -Insider dealing criminalised in limited circumstances
1993	Criminal Justice Act (CJA) was enacted.	Insider dealing was made a criminal offence with unlimited fine or imprisonment not exceeding seven years or both.
2000	-FSMA Act was passed - FSA was established	FSA can take civil action against insider dealing.
2005	MAD was adopted by amending the FSMA	-FSA can take civil action against seven types of market abuse. -Three forms of market abuse are considered to be types of insider dealing.
2016	Adopting new Market Abuse Directives	Small changes

Table 3.2 Milestones in the Development of Insider Dealing in the UK.

3.7 Insider dealing under Kuwaiti, Saudi and Qatari laws

The Gulf laws deal with the prevention of insider dealing in different ways. This thesis will focus on Kuwait, Qatar and Saudi Arabia.

3.7.1 Regulation

The following section explains the regulations in Kuwait, Saudi Arabia and Qatar. Kuwaiti law¹⁰⁴ seems to be less effective in the campaign against insider dealing. No framework of exact laws regulating insider dealing exists in Kuwait, although the Kuwait Capital Markets Act 2010 was passed to regulate the administration of the Stock Exchange and the trading of securities. The main advantage of the 2010 Act is that it provides criminal protection through provisions set out in Chapter 11, which make insider dealing a crime.

Before the 2010 Act, it could be clearly seen from the Kuwaiti Law of Commercial Companies Article No. 140¹⁰⁵ that the article banned members of the board of directors from buying or selling shares of the company upon whose board they served. Some commentators describe this as a unique action in comparison with other laws.¹⁰⁶ Article 164 of the new Act provides: ‘This law is a special law, its provisions are also special

¹⁰⁴ As mentioned in Chapter One, Islamic law is one source of Kuwaiti law. Accordingly, it would be wise to know the attitude of Islamic law toward insider dealing. From the viewpoint of Islam, insider dealing is fraud, termed ‘*taghrir*’. In general, any kind of fraud in any matter between individuals is illegal in Islam. Fraud is defined as a heinous and serious moral wrong. *Taghrir* involves using actions or words to mislead another. *Taghrir* might also occur in certain conditions and agreements well-known as a ‘trust sale’. So, the seller has the complete duty to disclose to the buyer all facts that could affect the price and the buyer’s decision to buy. In this respect, the definition of *taghrir* under the law of Islam is similar to the position of the American SEC Rule 10b-5. Abdul Jabbar Siti, ‘Insider dealing: Fraud in Islam?’ [2012] *Journal of Financial Crime*.

¹⁰⁵ The Kuwaiti Law Of Commercial Companies Article No. 140 provides:

No person, even though representing a legal entity, may be a director of more than three joint stock companies which have their head offices in Kuwait, neither may he be a delegated director or Board chairman for more than one joint stock company which has its head office in Kuwait. A director, even when representing a legal entity, may not take advantage of any information obtained by reason of his office, in order to obtain a benefit for him or another, nor may he sell or purchase the shares of a company so long as he is a director of such company.

¹⁰⁶ Ahmed Almehem (n 13) 437.

provisions, and this law shall repeal all laws in public or private law that are contrary to its provisions.’ Consequently, the Act regulates the nature of the work of a member of the board of directors, because each such member is an insider according to Article 118 of the Act. Based on the authority of Articles 164s and 118 of the 2010 Act, Article 140 of the Kuwaiti Law of Commercial Company is consequently repealed.

In Saudi Arabia, regulation is provided by part (c) in Article 50 of the Capital Market Law, which gives the Saudi Capital Market Authority (SCMA) the power to extend and establish the rules and to define the terms that help to apply and increase the effectiveness of investor protection.¹⁰⁷ In addition, the Saudi legislature approved criminal sanctions for insider dealing, which appear in Article 57(c) of Chapter 10, entitled ‘Sanctions and Penalties for Violations’. The maximum punishment for persons is five years’ imprisonment.¹⁰⁸

In Qatar, the governing legal regulation of the financial markets is Law No 33 of 2005 regarding Qatar’s financial markets authority, as amended by Article 2 of Law No 10 of 2009. The law delegated to the Qatar Market Authority the power to provide more definitions and this is specifically stated in Article 90: ‘The Authority may issue rules in respect of the scope and effect of the application of the Articles in chapter fifteen including: (1) defining inside information...’. On 7 August 2012, Qatar passed a new law No 8 of 2012 regarding the Qatar Financial Markets Authority, which repealed the 2005 law and subsequent amendments. Article 49 of 2012 makes insider trading a crime. The maximum punishment is three years’ imprisonment.

¹⁰⁷ Finally, Article 50(c) provides: ‘The Authority has the power to establish the rules for specifying and defining the terms provided for under paragraphs (a) and (b) of this Article, and such acts or practices which the Authority deems appropriate to exempt them from their application, as may be required for the safety of the market and the protection of investors’.

¹⁰⁸ Article 57(c) provides: ‘In addition to the penalties and financial compensation provided for under this Law, the Committee may, based on a claim filed by the Authority, punish the persons who violate Articles 49 and 50 with imprisonment terms not exceeding five years’.

It should be underlined that the idea of insider dealing is still not clear, although it was criminalised in Kuwait. As a result, there is much room for improvement; it is nonetheless a major step in the right direction. Combating insider dealing would be more effective if a new law were passed or if market rules were issued. In other words, the regulation of insider dealing in Kuwait must be improved in some way. Currently, the definition of insider dealing and the liability of the third party are not clear.

3.7.2 Definition

The following section defines insider dealing in Kuwaiti, Saudi and Qatari laws. The definition covers the insider, inside source, inside information and the prohibitive actions.

3.7.2.1 Kuwaiti law

The Kuwaiti legislature has not clearly defined the offence of insider dealing. Some researchers define the offence as an action by an insider, who personally benefits from inside information or who benefits others before the information becomes public in breach of the rules of justice, transparency and equality between dealers and outsiders.¹⁰⁹

The Kuwaiti legislature provides in Article 1 of the Kuwait Capital Markets Act 2010 that an ‘insider is any person who, due to his position, is informed of fundamental information or data regarding a listed company, which was not available to the public’. This definition presents four conditions that must be met for a person to be classed as an insider. 1) Due to his position: The Kuwaiti legislation does not define ‘position’ in terms of the person’s relationship with the employer or with the shareholders with whom they deal. As a result, the extent to which a tippee, an outsider or a third party is

¹⁰⁹ Adel Almane (n 18) 19.

included within this definition is uncertain. 2) Fundamental information or data: While fundamental information or data consists of material information, this definition does not set out the boundaries of such information or data; nor does it identify the standard by which information or data are determined to be material. 3) Listed company: The same Article of the 2010 Act defines the listed company as any shareholding company listed on the stock exchange market. 4) Non-public information: While it is important to describe a person as an insider when the information is not public knowledge, how can one determine whether information is public or not when the law does not provide a test to do this?

Consequently, the issues set out above identify shortcomings in the definition of an insider in the 2010 Act. Therefore, the definition should be improved by reference to English law, which has a fixed definition of insiders. Section 57 of the Criminal Justice Act 1993 provides: ‘Insiders: (1) for the purposes of this part, a person has information as an insider if and only if: (a) it is, and he knows that it is, insider information; (b) he has it, and knows that he has it, from an inside source.’ Part (1) (b) above is sometimes referred to as ‘tippee liability’ in the situation in which the insider gives a tip to another person, who trades on the basis of the tip.¹¹⁰

According to Article 118 of the 2010 Act, Kuwaiti law only bans the insider from doing one of the following actions:¹¹¹

¹¹⁰ Iain MacNeil (n 79) 413.

¹¹¹ Article 118 of the 2010 Act provides:

Punishable by imprisonment for a term not exceeding five years and a fine not less than the value of the benefit achieved or losses that were avoided or the amount of ten thousand dinars, whichever is higher, shall not exceed three times the value of the benefit achieved or losses that were avoided or the amount of one hundred thousand dinars, whichever is higher, or either penalties, any insider benefited or took advantage of inside information by buying or selling securities or disclosure of inside information or to give advice on the basis of inside information to someone who will not be an insider. The person who is trading in securities during the possession of internal beneficial information is described as an insider if the person is aware of them when

- 1) Benefitting from inside information. The Legislature assumes that an insider can benefit from inside information if he knows the nature of the information when buying or selling securities. The insider can refute this simple presumption through proof that he or she did not trade on the basis of this information in Kuwait.¹¹²
- 2) Taking advantage of inside information.
- 3) Disclosing the inside information.
- 4) Giving advice on the basis of inside information. Kuwaiti law limits the application of this article to the insider, which leaves unanswered the question of the outsider, especially the tippee.

In the United Kingdom, there are three independent offences according to the 1993 Act section 52:

- 1) Dealing based on inside information.
- 2) Disclosing inside information.
- 3) Encouraging another person to trade.

It would be beneficial for Kuwait to adopt a similar provision because the position is not clear in Kuwait.

3.7.2.2 Saudi law

The following section defines the terms ‘insider’, ‘inside source’ and ‘inside information’ and the activities prohibited in Saudi law. The Saudi legislature has defined an insider¹¹³ as any person who obtains inside information through a family, business or contractual relationship. More specifically, the market conduct

buying or selling only if he could prove he did not trade on the basis of that information.

¹¹² Ahmed Almelhem (n 14) 462.

¹¹³ Capital Market Law, Article 50(a).

regulations¹¹⁴ define an insider¹¹⁵ as anyone who gains access to inside information by reason of:

- a) Company relationship, such as a director, a senior executive or an employee of the issuer of a security related to inside information;
- b) Family relationship, such as a person who obtains inside information through a family relationship, including from a source related to the person who obtains the information;
- c) Business relationship, such as a person who obtains inside information through a business relationship, including obtaining the information from the issuer, or from any person who has a business relationship with the person who obtains the inside information, or from any person who is a business associate of the person who obtains the insider information;
- d) Contractual relationship, such as a person who obtains inside information through a contractual relationship, including obtaining the information from the issuer or from any person who has a contractual relationship with the person who obtains the inside information.

It can be seen from the above that there is confusion over what constitutes an insider and what is an inside source and the scope of the inside source is limited to four types in Saudi law. Therefore, this confusion would be avoided if Saudi law separated the definitions of 'insider' and 'inside source' and had not limited the scope of the inside source. For example, in the UK the Criminal Justice Act 1993 section 57 part (2) provides:

- (2) For the purpose... a person has information from an inside source if and only if, (a) he has it through- (i) being a director, employee or shareholder of an issuer of securities; or (ii) having access to the information by virtue of his employment, office or profession; or (b) the direct or indirect source of his information is a person within paragraph (a).

It would be also beneficial for Kuwait to adopt a similar provision.

¹¹⁴ Article 50(c) provides that the Capital Market Authority has the power to establish the rules for specifying and defining the terms provided for under paragraphs (a) and (b) relating to insider trading.

¹¹⁵ Market Conduct Regulations, Article 4.

In Article 50 of the Capital Market Law, the Saudi legislature defined inside information as information that meets three conditions: 1) Material Effect: this means that a normal person would realise that making this information available to the public would have a fundamental influence on the price or value of a security related to such information. 2) Non-public information: information that has not been disclosed and is not available to the general public. 3) Listed company: information that must be related to a traded security.

Under the Saudi Market Conduct Regulations two prohibitions relate to insider dealing. The first prohibits the disclosure of inside information by both insiders and outsiders when they know or should have known that the other person may trade in security related to inside information.¹¹⁶ The second prohibition is trading, including both insiders and outsiders if they know that they have obtained inside information.¹¹⁷

3.7.2.3 Qatari law

This section considers the definitions of ‘insider’, ‘inside source’, ‘inside information’ and the activities prohibited in Qatari law. According to the Qatar Act 2012, insider dealing is prohibited as follows: 1) It is not allowed for any person to deal in the

¹¹⁶ Article 5 of the Saudi Market Conduct Regulations provides:

Prohibition of disclosure of inside information. a. An insider is prohibited from disclosing any inside information to any other person when he knows or should have known that it is possible that such other person may trade in the security related to the inside information. b. A person who is not an 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.

¹¹⁷ Article 6 of the Saudi Market Conduct Regulations provides: ‘Prohibition of insider trading a. An insider is prohibited from engaging in insider trading. b. A person who is not an insider is prohibited from engaging in insider trading if he obtains the inside information from another person and he knows or should have known that the information is inside information’.

securities market based on non-public information,¹¹⁸ or 2) to disclose a secret relating to his work or his dealing,¹¹⁹ or 3) to trade in the market based on inside information relating to his work.¹²⁰

It can be seen that, in part (2) above, Qatari law uses the word ‘secret’ instead of ‘inside information’ and that in part (1) sub section 3 the Act bans anyone from dealing in securities based on inside information. This is vague because there is no definition of an insider or of inside information or inside source, and therefore it is unfair to punish a person if he does not know he is dealing with inside information.

3.8 Dealing with insider dealing in Kuwait

There are three important issues which have to be addressed in order to deal effectively with insider dealing. These are: the definition of the activity, the sanctions which should be available and enforcing civil or criminal liability.

3.8.1 A Sound Definition

After discussing the situation in Kuwait, Qatar and Saudi Arabia, it should be underlined that in spite of the fact that these countries have passed new laws in order to combat insider trading, there are still shortcomings such as the lack of a clear definition, especially in Kuwait and Qatar. Moreover, tippee operation is not covered in Kuwait. It would be helpful to learn from the experience of the USA and the UK, who have a long history of improving their laws in this field. For example, in the United States the definitions of an insider have changed with the cases and have been extended as

¹¹⁸ Article No 34 of the law No 8 of 2012 regarding Qatar Financial Markets Authority.

¹¹⁹ Qatar Act 2012, Article 40 part 1.

¹²⁰ idem part 2.

follows.¹²¹ 1) Insiders: this term covers all corporate employees. 2) Constructive Insiders: in some situations, information is revealed legitimately to a professional person, such as an accountant or a lawyer working for the company, but not employed by the company. Such an outsider may become a fiduciary of shareholders, because the outsider entered into a special confidential relationship with the company, and the information is disclosed to them in confidence. However, this idea of treating an outsider as an insider based on his or her relationship, in which there is an expectation of confidentiality, was not universally accepted. In *Dirks*, for example, the Court stated that an individual must expressly or implicitly enter into a fiduciary relationship with the issuer. 3) Tipsters and tippees: Tippees can be held liable provided two conditions are met. The tipster must have breached a fiduciary duty to the company by making the tip, and the tippee must know or have reason to know of the breach. 4) Non-traditional relationship: Beyond the above traditional relationships, matters get very complicated, and each case must be examined on its merits. For example, is a doctor who learned confidential information from a patient an insider? Similarly, is there a fiduciary relationship between spouses? 5) Legislators: Another category of non-traditional insider is that of a legislator, like a member of Congress, who can access material non-public information in a variety of ways, such as in a Congressional hearing. It should be noted that none of the Qatari, Saudi and Kuwaiti laws ban legislators from dealing with inside information.

There is a time frame for the use of inside information, which is the period before the information reaches the public.¹²² Many scholars maintain that the ban against dealing should not end just when the inside information is made public: an insider must wait for public investors to have an opportunity to act on it.¹²³ It should be noted that none of the Qatari, Saudi or Kuwaiti laws mention this point.

¹²¹ Stephen Bainbridge, *An Overview* (n 8) 14-20.

¹²² Saleh Alberbari, 'Stock Markets and Use of the Inside Information by Insiders A Comparative Legal Study'. (Paper presented to the Conference of Securities Markets and Stock Exchanges, United Arab Emirates University College of Sharia and Law) 26.

¹²³ Stephen Bainbridge, *An Overview* (n 8) 12.

In the United States, two types of non-public information are specified. One is information that derives from internal corporate sources and is classed as ‘inside information’. The other is ‘market information’ that originates outside of the company and affects the price of its securities but does not relate to its assets or earning power. The use of either is prohibited.¹²⁴ It should be noted that none of the Qatari, Saudi or Kuwaiti laws mention this point.

It is important to have a clear definition of insider dealing. The perfect definition has to cover the following four areas: who is an insider, what is the inside information, how is the inside information transferred and what type of activity is banned. The UK Criminal Justice Act 1993 (CJA) is a good illustration whereby section 57(1) defines an insider, section 57(2) defines an inside source, section 56¹²⁵ defines inside information and section 52 defines prohibited activities. It should be noted that none of the Qatari, Saudi or Kuwaiti laws define insider dealing in this way.

One overriding difference between the US regime on insider trading and that of the UK regime is in the promulgation and application of the law. In the US, the Securities Exchange Act 1934 does not mention insider dealing let alone define it. Reference is made to ‘use or employ... any manipulative or deceptive device or contrivance...’. It is left to the judges to decide according to common law whether an act constitutes insider dealing. On the other hand, the UK statute makes specific reference to insider dealing and prohibits it. Kuwait, Qatar and Saudi Arabia ought to follow the example of the UK rather than that of the USA if they need to improve their legislation.

¹²⁴ibid 11.

¹²⁵ In the United Kingdom, information can be defined as inside information if the following four conditions are met:

- (1) relates to particular securities or to a particular issuer of securities or to particular issuers of securities and not to securities generally or to issuers of securities generally;
- (2) is specific or precise;
- (3) has not been made public;
- (4) if made public, it would likely have a significant effect on the price of any securities.

Both principles-based and rules-based regulation are derived from statute. Principles based regulation means avoiding detailed and prescriptive rules in the statute and just relying on high level rules. It is used by giving a general definition or prohibition with the details left to secondary legislation (rulemaking by a regulatory authority) or case law to develop and interpret the principle). Principles based regulation is more flexible and able to rapidly change in order to stop any problems arising in the future. Principles based regulation also uses general terms such as fair, reasonable, suitable and fair treatment of customers.¹²⁶

Rules based regulation is detailed and anticipates every possible situation. It is different from rules that are passed by a regulatory authority. Rules based regulation can lead to gaps because it has to cover all the problems and if a new problem appears the regulation itself needs to be changed which would take time. One advantage of rules based regulation is that it is clear. However, it narrows the legal judgments power because it limits the interpretation and decision making power, It has to follow the rules and it is like a mechanical decision.¹²⁷

For example, in USA they use the principles based regulation to ban insider trading by using general terms in the Securities Exchange Act 1934 ‘to use or employ..any manipulative or deceptive device or contrivance” and leaves secondary law and case law to interpret and develop that term which banned insider trading and still develops it by using rules and cases such as rule 10b-5 and misappropriation theory. However, in the UK they use rules based regulation that bans insider dealing directly and defines the insider dealing in the Criminal Justice Act 1993 and Financial Services and Market Act 2000.

In some situations the principles based regulation can be applied more easily by giving a regulatory authority the power to decide how to implement the principles but with the

¹²⁶ < https://www.lse.ac.uk/collections/law/projects/lfm/lfmr_13_blacketal_191to206.pdf > accessed 13 Nov. 2015

¹²⁷ *ibid*

complexity of insider dealing and some people still think there is nothing wrong with insider dealing action, it is better to have clear statutory rules passed to stop this debate.

In Kuwait, the role of the Act is to provide a clear definition of insider dealing. The legal system in Kuwait is different from the situation in the USA where the secondary regulation (Rule- 10-b) and case law were involved in clarifying the unclear definition in 1934 Act relating to insider dealing. This means that the only way to clarify the Kuwaiti definition of insider dealing is by changing the Act itself. The Kuwait 2010 Act uses rule based regulation by banning insider dealing directly and defining it but the Act misses some important details such as a tippee is not included in the definition.

3.8.2 Sanctions

Martin Wheatley, the FCA chief executive, mentions that fighting financial crime (including insider dealing) is not straightforward. The enforcement mechanism needs a new style of regulation, new powers, and a new philosophy, with a clear mandate to pursue prosecution, impose unlimited fines, ban individuals from financial services and prevent, reduce and deter future insider dealing.¹²⁸ That cannot be achieved without having a sound regulatory authority. This will be discussed in detail in chapter six.

There are two types of sanctions related to insider dealing: administrative (civil) and criminal sanctions. There are a number of administrative sanctions such as a temporary suspension from trading and fines. Criminal sanctions include prison, but not for companies, and criminal fines.

A question that is often asked is why do securities regulations not have provision for victims of insider dealing to sue inside dealers for damages to compensate them for any losses which they sustained as a result of the inside dealer's actions. One argument

¹²⁸ 'The Changing Face of Financial Crime' (Speech at the FCA Financial Crime Conference 2013 <<http://www.fca.org.uk/news/speeches/the-changing-face-of-financial-crime>> accessed 7 February 2015.

against having such provision is that it is difficult to prove that someone has been the victim of insider dealing. Neither the UK, Kuwait,¹²⁹ Saudi nor Qatar allow for specific civil liability arising from insider dealing. The Saudi legislature prescribes civil and criminal liabilities for so-called ‘manipulation’,¹³⁰ while insider dealing is subject only to criminal sanctions even though both manipulation and insider dealing are forms of market abuse.¹³¹

Some say that administrative (civil) sanctions for insider dealing should always be a financial penalty. A person convicted of insider dealing must return the profit made or the loss avoided. Some say that the funds should not go to the market players but should go to the state.¹³² In one year the FCA handed out a record of £1,471,431,800 in fines in 2014.¹³³

This section discusses the administrative (civil) fines, settlement and legal entity’s responsibility in Kuwait, Qatar and Saudi. It should be noted that in the UK, the FCA has an extensive range of disciplinary, criminal and civil powers according to FSMA 2000. This means that the FCA has two choices. It could use one or all of them, as in the case of insider dealing, where it can resort to criminal proceedings or use its administrative powers to apply sanctions.¹³⁴ In the case of the latter, a prescribed enforcement procedure has to be followed (See appendix 1).

¹²⁹ The Kuwaiti legislature imposes criminal sanctions for insider dealing, but it does not provide for specific civil. Consequently, the general rules of civil liability must be relied upon.

¹³⁰ Saudi Capital Market Law Article 57A provides: ‘Any person who violates Article 49 of this law...shall be liable for damages to any person who purchases or sells the security the price of which has been significantly adversely affected by such manipulation ...’.

¹³¹ Saudi Capital Market Law Article 57 Part C provides: ‘In addition to the penalties and financial compensation provided for under this law, the committee may, based on a claim filed by the Authority, punish the persons who violate Articles 49 and 50 with imprisonment terms not exceeding five years.’

¹³² Alexander (n 15) 235.

¹³³ <<http://www.fca.org.uk/firms/being-regulated/enforcement/fines/2014>> accessed 23 June 2015

¹³⁴ <<http://www.fca.org.uk/static/documents/enforcement-information-guide.pdf>> accessed 17 May 2014.

Article 146 of the Kuwaiti Act 2010 provides that the disciplinary board may impose any of seventeen different kinds of penalties, including a caution or warning, but it does not include any financial penalty. By comparison, the sanctions available to the FCA in the UK include an unlimited financial penalty.¹³⁵ However, in Saudi, the Capital Market Authority may impose a financial fine, which shall not be less than SR 10,000 and shall not exceed SR 100,000 for each violation committed by the defendant.¹³⁶ Moreover, in Article 35 of the Qatari Law 2012 No 8, the limit of fines shall not exceed QR 10,000,000. It would be a good idea to give the Kuwait Capital Market Authority (KCMA) the power to impose fines.

Article 131 of the Kuwaiti Act 2010 gives the defendant and the Authority the option to reach a financial settlement at any time during the criminal trial. The offer of a settlement can be initiated by either party. The settlement amount shall not exceed the maximum fine and shall not be less than the minimum criminal fine stipulated in Article 118 of the 2010 Act. In Article 64 of the Saudi Capital Market Law there is a similar provision to avoid criminal proceedings, but any settlement must be reached before proceedings have commenced. In Qatar, Article 49 of the Qatari Law 2012 gives the chairman of the Authority the option to reach a financial settlement before proceedings have commenced or at any time during the trial. Therefore, the Qatari legislator gives greater rights to the Authority because a settlement can be reached either before or during the proceedings. Apart from the potential financial advantage of reaching a settlement, there are other advantages, such as avoiding imprisonment and salvaging one's reputation.

The Kuwaiti Act 2010 should mention the legal entity that is liable, because criminal responsibility for a non-natural person is not accepted under the general rules. As a result, the legislature did not draw a clear policy for dealing with this issue. Kuwaiti law needs a special organisation to address this insufficiency, such as Law 35 of 2002

¹³⁵ Section 123 of the 2000 Act about the power to impose penalties said that 'if the Authority is satisfied that a person... is or has engaged in market abuse...it may impose on him a penalty of such amount as it considers appropriate...' Also see Iwona Seredyńska (n 4) 125-132.

¹³⁶ Saudi Capital Law, Article 59.

Regarding Combating Money Laundering Operations, which provides in Article 12: ‘without prejudice to the criminal liability of a natural person stated therein, the companies of those persons who are criminally questionable for the crimes.... shall be punished with a fine not exceeding one million dinars if the crime is committed in its interest ...’.¹³⁷ Even though both Saudi and Kuwaiti laws fail to clarify the legal entity’s criminal responsibility, the Qatari legislator holds a company manager criminally responsible if he knows or if he breaches his administrative duties according to Article 42 of Qatari Law No 8 2012.¹³⁸

3.8.3 Criminal or civil enforcement

Although some scholars completely disagree with the criminal provision in insider dealing, keeping the criminal sanction as an option is an excellent idea.¹³⁹ It is argued that a criminal sanction is a major deterrent to insider dealing, because there is the possibility of imprisonment. There is also the potential for the stigma of having been convicted of a crime that will follow the person throughout his or her life.¹⁴⁰ Applying administrative sanctions is easier than applying criminal sanctions. For example, in the UK, until 2009, the FSA (now FCA) was reluctant to prosecute cases under criminal law because of the higher standard of proof required. However, with the arrival of the financial crisis, the FSA (now FCA) has increased the number of criminal prosecutions, with a considerable rate of success. The FCA has secured 27 convictions related to

¹³⁷ Adel Almane (n 18) 31.

¹³⁸ Qatar Capital Market Act 2012 Article (42) mentions that:

The person who is in charge of the management of a legal person de facto shall be punished by the same sanctions set out for acts that contravene the provisions of this law, if its knowledge is evidenced; or if its failure to duties imposed such management contributed in occurrence of the crime. A legal person shall be jointly liable to pay the ordered fines and compensations if the violation is committed by one of legal person’s employees in the name of or for the legal person.

¹³⁹ Alexander (n 14) 231.

¹⁴⁰ *ibid* 232.

insider dealing till present time.¹⁴¹ Therefore, one should not be put off bringing criminal prosecutions, which some people feel is a bigger deterrent than a civil action.

The most inflexible problem with proving insider dealing is obtaining evidence, which can hinder prosecuting those involved in this crime.¹⁴² One effective method of overcoming this problem is to award ‘bounty rewards’ to those who provide evidence that leads to a conviction. This practice exists in the USA. For example, a bounty may be offered in the amount of 10 percent of the civil penalty collected, if a person provides information that leads to civil penalties. Such a bounty encourages informants¹⁴³ and eases the difficulties involved in collecting evidence.¹⁴⁴

Despite the fact that insider dealing has been criminalised in Kuwait, the need for comprehensive and effective laws is still not taken seriously in all developing countries, including Kuwait.

3.9 Conclusion

This chapter has dealt with the protection of investors in Kuwait from insider dealing under the 2010 Act. The laws on insider dealing have a long and controversial history, because some people believe that insider dealing should not be illegal. Nevertheless, nearly every country bans insider dealing.

¹⁴¹ Since it is difficult to prosecute cases of insider dealing in the traditional ways, regulators have changed their policy whereby there more attention is given to bringing criminal prosecutions rather than civil sanctions to fight this crime. This evidence that this policy is working in the UK is clear that before 2009 there were no criminal convictions while between 2009 and the present day there have been 27 convictions.< <http://www.fca.org.uk/news/three-charged-with-insider-dealing>> accessed 19 June 2015

¹⁴² Brenda Hannigan (n 15) 21.

¹⁴³ Alan Palmiter, *Securities Regulation* (6th edn, Aspen Publishers 2014) 370.

¹⁴⁴ Insider Trading and Securities Fraud Enforcement Act 1988 section 21A e (ITSFEA).

Insider dealing has been defined in terms of what constitutes an insider and inside information and the manner in which the latter is transferred. Moreover, the chapter has examined the ways in which it is combated in various countries. By comparing Qatari, Saudi, UK and US legislation, it has found that Kuwaiti law has not properly defined insider dealing. For example, a tippee is not considered an insider. The existing legal framework for the regulation of insider dealing in the Kuwait stock market was discussed by reference to American law, because the United States has a long history and extensive experience in this regard. Some important issues that must be addressed to deal effectively with insider dealing have been highlighted, such as having a proper definition and appropriate administrative, civil and criminal sanctions. Kuwaiti law does not empower its regulatory authority to pass administrative fines to combat insider dealing.

Insider dealing is a complicated crime that is not easy to combat. It is particularly difficult to bring a criminal prosecution because of the high burden of proof that is required. For example, in the UK, even though insider dealing was criminalised in 1993, the first case did not come to court until 2009.¹⁴⁵ In the US, the law against insider dealing has been developed over the last eighteen years. In Qatar, Saudi Arabia and Kuwait, no case involving insider dealing has ever been brought. Because of the complexity of insider dealing, passing laws to regulate it and establishing appropriate authorities to enforce it takes a long time; furthermore, it needs to be accompanied by a change the financial culture.

Requiring fair disclosure is one way to combat insider dealing. The next chapter will discuss fair disclosure and examine the 2010 Act in terms of protecting investors

¹⁴⁵ Jack Davies, *From Gentlemanly Expectations to Regulatory Principles: a History of Insider Dealing in the UK (Pt.2)*, (2015) *Company Lawyer* 2015 36(6) 170

Chapter Four

Disclosure of Inside Information by Listed Companies

4.1 Introduction

This chapter aims to answer the question about whether the 2010 Act provides adequate protection to individual investors in terms of unfair disclosure. Inside information means that specific information related to the company if published, would be likely to have a significant effect on share prices. It is a piece of key information that makes individual investors aware of fundamental benefits and risks when making an investment decision (buying, selling or deferring investment). Disclosure of inside information should be accurate, honest, understandable, full, timely and not misleading.¹

Fair disclosure is one way to protect investors by ensuring that all investors have equal opportunity to access and know about inside information at an appropriate time and in an appropriate way. Some say that ‘informed investors are protected investors’.²

The disclosure of inside information by listed companies is one of the most important objectives of the Kuwait, securities market. For instance, the Kuwait legislation stresses the importance of disclosure of information in accordance with the provision of Article 3 of Kuwaiti Law No 7 of 2010, which says that one of the Kuwaiti Capital Market

¹ Georgina Philippuo, the FCA’s acting director of enforcement and market oversight, confirmed that by saying ‘clear and timely disclosure of share dealings is an important way of ensuring that markets are fair and are seen to be fair’. An enforcement decision made by the FCA to fine Reckitt Benckiser £ 539,800 for listing rule failures in 2015.

² John T A Burke, ‘Re-examining investor protection in Europe and the US’ [2009] eLaw Journal: Murdoch University Electronic Journal of Law 16 (2) 10.

<<http://elaw.murdoch.edu.au/index.php/elawmurdoch/article/viewFile/38/13>> accessed 2 May 2015.

Authority's objectives is 'implementation of a policy of full disclosure in order to achieve justice, transparency and prevent conflicts of interest and the exploitation of inside information'.

The question here is how to enhance the information disclosure regime in Kuwait and avoid the lack of access to information in order to protect investors. Without doubt, disclosure of inside information plays a significant role in protecting investors, because they rely on this information to make their investment decisions. Information disclosure is a key element in the protection of investors.³

Several forms of disclosure are required from companies, such as notification of transactions by persons discharging managerial responsibilities (disclosure of dealing), periodic reporting (annual and half-yearly reports), notification of the acquisition or disposal of major shareholdings,⁴ including, for example, acquisition or disposal of any fixed assets of the listed company by issuers, and finally the continuing obligations to disclose inside information from the moment the company applies for listing and throughout its life. This thesis will concentrate on inside information, because it plays a significant role in the market and is related to investor protection.. Importantly, in some situations, other disclosures have the potential to be considered inside information, such as early profit warnings.⁵

³ *ibid.*

⁴ For instance, in the enforcement decision taken by the FSA in August 2011 against a retired chairman of Wm Morrison Supermarkets PLC, Sir Ken Morrison was fined £210,000 for violating Disclosure and Transparency Rules by reducing his shareholding and voting rights without disclosure. FSA/PN/072/2011. <<http://www.fsa.gov.uk/library/communication/pr/2011/072.shtml>> accessed 20 May 2013.

⁵ In addition to financial information, there is non-financial information such as changing of members of the board and key executives.

This chapter will discuss the existing Kuwait, Qatar and Saudi disclosure regime when a company lists its shares to trade on a public market, such as the stock exchange, but does not include a public offer⁶ of its shares.

The question is how to enhance the disclosure regime in Kuwait to be able to prevent a future problem in equities markets and attempt to control that regime by highlighting some shortcomings in the recent rules or closing existing loopholes so that listed companies cannot abuse the rules by breaching information disclosure regulations or avoid them by using a legal loophole.

This chapter will examine the existing disclosure rules which apply to equity shares in Kuwait compared to Saudi Arabia, Qatar, and the UK's disclosure regimes as examples of developed countries.⁷

4.2 The Regulatory Framework for Disclosure

The disclosure of inside information by listed companies is governed by several rules, which often overlap. The first set of rules consists of the Listing Rules, which impose a continuing obligation under the listing rules of equity shares for listed companies to disclose meaningful information. The second set of rules for listed companies is comprised of the Disclosure Rules. For example, the UK and Kuwait have specific rules for disclosure. The third set is comprised of the Market Abuse Rules and the fourth set is comprised of the criminal offences associated with disclosure. Some describe the first two as positive obligations of disclosure and the last two as negative obligations relating to disclosure.⁸ These rules have the potential to provide better protection for investors

⁶ There are three kinds of public offers. The first is offering new shares that are to be issued by the company; the second is offering shares that are already in issue; the third is a combination of both. Iain MacNeil, *An Introduction to The Law on Financial Investment*, (2nd edn, Hart Publishing Ltd) 277

⁷ In this chapter, the disclosure regime of the USA will not be covered because it is believed that it is sufficient to consider the UK as an example of a developed county.

⁸ Brian McDonnell, *A Practitioner's Guide to Inside Information* (2nd edn, Sweet & Maxwell 2012) 7.

by ensuring that the market operates on the basis of equal access and fair disclosure of inside information and by ensuring that the disclosure does not mislead investors' decisions. The above rules overlap in certain circumstances; for instance, according to the listing rules in the UK, which also includes listing principles, LR (9.2.5G), a listed company must comply with the Disclosure and Transparency Rules (DTRs). In addition, there is an overlap with s118 (market abuse) and s397 (misleading statements and practices) that will be discussed later.

Both the listing rules and the disclosure rules have provisions governing the disclosure of inside information. These overlaps are too numerous to list. However an illustration of such overlaps can be seen in the enforcement decision of the FSA (now FCA) in the UK against Woolworths Group plc for breaching of disclosure rule 2.2.1 and listing principle 4 which saw the company fined £350,000 pounds in 2008.⁹

The following section considers regulation in the UK, Kuwait, Qatar and Saudi.

4.2.1 United Kingdom

EU legislation on ongoing disclosure of insider information is based on the European Union Market Abuse Directive 2003/6/EC¹⁰ and the Transparency Directive¹¹. The issuer has to disclose inside information 'as soon as possible'. This is one obligation which the issuer has to meet. The aim of this obligation is to limit the opportunity for abuse of the market.¹² According to the MAD the issuer could delay the disclosure if the delay would not mislead the public.¹³

⁹ FSA/PN/056/2008, an enforcement decision was made by the FSA.

¹⁰ Directive 2003/6/EC.

¹¹ Directive 2004/109/EC.

¹² Niamh Moloney, *EU Securities And Financial Markets Regulation* (3rd ed, Oxford University Press 2014) 730

¹³ *ibid* 731

Only continuing disclosure obligations and not periodic ones will be considered here. Before 2005, the disclosure obligations were part of the listing rules which are known as Admission of Securities to Quotation or Admission of Securities to Listing.¹⁴ In 2005, the Disclosure Rules were introduced to implement the Market Abuse Directive (MAD).¹⁵ During that same year, in the UK the FSA (now FCA) extended the listing regime by adding Listing Principles (11 Principles) to implement the MAD. The Financial Services Authority believed that these principles would support the requirements of European Law.¹⁶ For example, Listing Principle 2 establishes procedures, systems and controls for disclosing information and is one of the positive obligations imposed on an issuer to comply with the rules of the UK Listing Authority (UKLA).¹⁷ UK legislation on fair disclosure of insider information is based on European Union Market Abuse Directive 2003/6/EC.

In 2007, to implement the Transparency Directive¹⁸ new rules were added to the Disclosure Rules, which then became the Disclosure and Transparency Rules (DTR). Moreover, in 2008, DTRs 1B and 7 (Corporate Governance Code) were added to implement parts of the Statutory Audit Directive¹⁹ and the Company Reporting Directive.^{20,21} In this chapter, DTR will be used to mean the Disclosure and Transparency Rules.

¹⁴ <http://www.fsa.gov.uk/pages/library/policy/listing_rules/index.shtml> accessed 21 February 2015.

¹⁵ Directive 2003/6/EC.

¹⁶ Brian McDonnell (n 8) 16.

¹⁷ *ibid* 8.

¹⁸ Directive 2004/109/ EC.

¹⁹ Directive 2006/43/EC.

²⁰ Directive 2006/46/EC.

²¹ Brian McDonnell (n 8) 19.

MAD applies to all issuers of securities that are admitted to trading on a regulated market.²² Therefore, this chapter regarding the UK regime is limited to a premium listing of equity shares.

In 2014 a new directive (MAD)²³ was passed to address and clarify some issues related to disclosure of inside information such as delaying mechanism, selective disclosure and insider lists.²⁴ Small changes have been introduced. The definition of inside information has been slightly changed, to apply to more financial instruments, delay inside information disclosure is not for the legitimate interest, there is a new format of insider lists and a written form of delay explanation.²⁵

4.2.2 Kuwait, Qatar and Saudi

In some GCC countries, like Qatar and Saudi, there is no distinction between disclosure rules and listing rules. There are only listing rules which comprise rules about how to access the market as well as rules about the disclosure of information. However, Kuwait relies on listing rules as well as disclosure rules to control the disclosure of information. Although the name of these rules is similar to the UK, their provisions are not as comprehensive as the UK.

Saudi and Qatari legislation regulates disclosure according to Listing Rules passed on 25 November 2012 and the Offering and Listing Rulebook of Securities issued in November 2010, respectively. However, the basic statutory framework for disclosure of

²² Louise Wolfson, *Continuing Obligations: A Practitioner's Guide to the Financial Services Authority Listing Regime 2012/2013* (25th edn, Thompson Reuters 2012) 224.

²³ Directive No. 596/2014 (Regulation No.596/2014 the European Parliament and of the Council of 16 April 2014 on Market Abuse (Market Abuse Regulation) and repealing Directive 2003/6/EC of the European Parliament and the Council Commission Directives 2003/124/EU, 2003/125/EC, 2004/72/EC).

²⁴ *ibid* 733-736

²⁵ <<http://www.twobirds.com/~media/PDFs/News/Articles/2014/Compliance%20officer%20bulletin%20-%20market%20abuse.pdf>> accessed 6 October 2015

securities in Kuwait is set by the Capital Market Authority in two rules, Rule No 3 of 2011, relating to listing, and Rule No 2 of 2012, relating to disclosure.

Listing rules and disclosure rules will now be considered in more detail.

4.3 Listing Rules

The following sets out the definition of listing rules and sanctions for breach of listing rules.

4.3.1 What are Listing Rules?

An important role in the protection of investors is fulfilled by listing. Before securities can be listed the authorities ensure that disclosure requirements are met and in order for the securities to continue to be listed, a complete and exact disclosure of relevant information must be made on a timely basis to facilitate the orderly operation of the stock exchange market.²⁶

Listing rules can be described as private law that is binding only as a matter of contract between the listed company (any shareholding company listed on the stock exchange market) and the stock exchange.²⁷ The part of the listing rules governing disclosure is different from the part stipulating the conditions for listing, which have to be satisfied before any shares of a company can be traded on a stock exchange.²⁸

²⁶ Jonathan Fisher, Jane Bewsey, Malcolm Wayers and Elizabeth Ovey, *The Law of Investor Protection* (2nd edn, Sweet & Maxwell 2003) 120.

²⁷ Gordon Walker, Terry Reid, Pamela Hanrahan, Ian Ramsay, Geoff Stapledon, *Commercial Applications of Company Law in New Zealand* (5th edn, CCH 2015) 35.

²⁸ Jonathan Fisher and others (n 26) 119.

There is a difference between listing and public offers. The former means a regulatory method that makes the securities of a company eligible for trading on a regulated market, while the latter is an invitation to the general public to purchase securities. Listed or unlisted securities can be the subject of a public offer.²⁹

The question here is how listing rules can protect investors by ensuring that they have reasonable access to inside information. History has shown that the conversion of stock exchanges themselves to listed companies in their own right has resulted in a lot of competition for profits. This affects the regulation of stock exchanges and can increase the risk of a regulatory ‘race to the bottom’ as a result of the conflicts of interest between the profit of the stock exchange and the responsibility to regulate.³⁰ This development has also led to the rapid development of technology, and the creation of new financial instruments has increased the importance of the stock exchange as a provider, in a competitive market, of specific services, such as trading.³¹ Further, today there is international competition between stock exchanges in different countries.³² For example, although Kuwaiti companies sought in the past to list their shares on the Kuwait Stock Exchange (KSE), recently some listed companies have considered withdrawing from the stock market, possibly to seek listing on another exchange. During the last five years, seven non-Kuwaiti companies have de-listed the Kuwait Stock Market. In the past, the Kuwait Stock Exchange comprised 215 companies. After the new listing rules were passed in 2011 that number shrank to about 198 companies.³³ Today, that number is 205.³⁴

²⁹ Iain MacNeil, *An Introduction to The Law on Financial Investment*, (2nd edn, Hart Publishing Ltd) 279

³⁰ Hans Christiansen and Alissa Koldertsova, *The Role Of Stock Exchanges in Corporate Governance*, (OECD 2009) 1.

³¹ *ibid* 13.

³² *ibid*.

³³ <<http://www.alanba.com.kw/ar/economy-news/357596/31-01-2013>> accessed 2 May 2015.

³⁴ <<http://www.kuwaitse.com/A/Stock/Companies.aspx>> accessed 12 June 2015.

It is important to note that the fewer the companies in the stock market, the lower the profits³⁵ to the stock exchange. On the other hand, when the listing rules are less stringent, there is the potential to increase the likelihood of damage to the small investors and affect the reputation of the market international. One way of solving this problem is to apply a compulsory listing. In Kuwait, for example, Article 2 of the Capital Markets Authority Decision No 3 of 2011 regarding the listing system in the Stock Exchange mentions that public shareholding companies established in Kuwait cannot apply for listing in Kuwait before the second fiscal year of the company. If the company does not request listing during this period, the Authority must halt the activities of the company. Companies wholly owned by the state are exempt. Saudi Article 3b of Listing Rules 2012 creates a mandatory relationship between offering securities to the public and the listing by requiring the issuer to submit to the Authority an application for registration and admission to listing. In Qatar, according to Article 62 of the Offering and Listing Rulebook of Securities 2011, every Qatari shareholding company must apply to the Qatar Financial Markets Authority within a maximum of three months from the end of the public offer. The longer period between establishment and listing period provided for in Kuwait is preferable, because it is a period during which investors can evaluate the company's activity and the fair price of its shares, as can be clearly seen from the past experiences with the listing of Saudi and Qatari companies after a short period.

Gulf States differ in terms of listing rules. It is important to separate the body that establishes the rules from that which gives permission for listing, from stock exchanges. In Kuwait, admission to listing and the setting of the rules are controlled by an organisation, the Capital Market Authority, which is separate from the Kuwaiti Stock Exchange. Kuwait Decision No 3 of 2011 sets out listing rules. The first rule is that the Stock Exchange shall not list any company without the approval of the Authority. This condition applies to both the official market and the parallel market.³⁶ According to

³⁵ According to Article 7 of Resolution No. 3 2011, in the Kuwaiti Stock Exchange, the listing companies are required to pay an annual subscription of 0.05% of paid-up capital, not to exceed 50 thousand KD.

³⁶ In Kuwait, there are two markets: the official market and the parallel market. The parallel market was established in 2000 and has a lower threshold for admission. For example, in the official market a company must have at least two hundred shareholders; the parallel market requires only fifty.

Article 30 of the previous decision No 3, the Kuwaiti legislature has given the Authority the power to refuse any application for listing, if it is not in the best interests of the country. The Saudi Arabian legislature has given this power to the exchange market indirectly by separating the proposal and approval according to Article 23 of the Saudi Capital Market Authority (SCMA) Law. This requires that the Authority submit the conditions for the listing of and trading in securities for approval after the Board of Directors of the Exchange proposes them. Therefore, it would be better if the Saudi legislature had given the power to suggest the listing rules to the Saudi Authority, as did the Kuwaiti legislature.

The Kuwait, Qatar and Saudi Stock Exchanges have a number of general conditions for listing, such as an appropriate record of the capital,³⁷ profits,³⁸ general assembly,³⁹ and number of shareholders.⁴⁰ Listing rules have developed over time. For example, in the past the Kuwaiti listing rules covered some kinds of companies but, at the same time,

³⁷ In Kuwait, the company's issued capital should be fully paid and should not be less than 10 million Kuwaiti Dinars. Compared with Saudi and Qatar, the Saudi Arabian Stock Exchange requires almost the same value, while the Qatar Stock Exchange requires less than half the capital value. This requirement gives the Qatar Exchange preference in the region, but it may face a serious risk in future.

³⁸ In Kuwait, the company shall have achieved a net profit in the last two fiscal years. The annual net profit shall not be less than 7.5% of the paid-in capital. The Saudi Legislation does not mention profits and losses, but says only that, in the last three financial years, an issuer must have announced its audited financial statements. The same requirement is found in the Qatar Listing Rules.

³⁹ In Kuwait, the company should obtain the approval of its general assembly to list its share stock exchange. In Saudi Arabia, each Saudi company wishing to be listed in the Saudi market must offer part of its securities by way of a public offering, and, without the approval of the issuer's board the offeror cannot offer securities to the public. The Kuwaiti legislature is sure to obtain the approval of the General Assembly, while the Saudi legislation requires the approval of the Board. Qatari legislation, in Article 38 2010 Rulebook, requires the approval of the Board of Directors and of the General Assembly depending on the conditional documents of the issuer.

⁴⁰ In Kuwait, there must be at least two hundred shareholders. Compared with Saudi and Qatar, Saudi Arabia's Stock Exchange requires almost the same number of shareholders, while the Qatar Stock Exchange requires that the company have at least thirty shareholders. This requirement also gives the Qatar Exchange preference in the region, but it may face a serious risk in the future.

ignored other types of companies, such as overseas listings. However, Rule No 3 of 2011 covers them.

In the UK, the official list has two segments: the first is the premium (formerly primary) segment, and the second is the standard (formerly secondary) segment. The issuer can apply to either of them. In general, transferring between the two segments can be done without cancelling the issuer's listing but with twenty days' notice to the FSA (now FCA).⁴¹ There are minimum requirements⁴² for both segments. These requirements are known as Directive Minimum Standards derived from EU directive standards. However, the premium segment has additional requirements known as super-equivalent standards. The premium segment is only for equity shares.⁴³ The issuers must have two admissions to be able to trade their securities. The first is admission to listing from the UKLA;⁴⁴ the second is admission to trading from the London Stock Exchange⁴⁵ (LSE).⁴⁶

4.3.2 Sanctions for Breach of Listing Rules

Administrative actions are usually imposed against the listed company for breach of listed rules, including suspension, cancellation and restoring listing. This chapter will discuss suspension and cancellation.

⁴¹ According to LR 5.4A.3 part 3. See also Michael Blair QC, George Walker and Stuart Willey, *Financial Markets and Exchanges Law* (2012, 2nd edn, Oxford University Press) 175 -178.

⁴² That includes validly issued and freely transferable shares, due incorporation and a minimum capitalisation. For example, LR 2.2.7 mentions that 'the expected aggregate market value of all securities to be listed must be at least £ 700,000 for shares'.

⁴³ Herbert Smith, *A Practical Guide to the UK Listing Regime* (2nd edn, ICSA 2011) 48-49.

⁴⁴ The UKLA is one of the FCA divisions. The UKLA is responsible for regulation of the granting of right to securities listed in the official List (premium or standard segment).

⁴⁵ LSE has market rules with which companies must comply, such as Rule 1.8, which requires the listed company to have a contact person who is responsible for ongoing disclosure and to inform the LSE of any change in this person; Herbert Smith (n43) 35.

⁴⁶ <<http://www.londonstockexchange.com/companies-and-advisors/main-market/companies/listing/process.htm>> accessed 26 June 2015

4.3.2.1 Cancellation

Cancellation means de-listing a company from the stock exchange. In the UK, according to LR 5.2.1 R the FCA has a power to cancel any companies from listing if it is satisfied that there are special circumstances that preclude normal regular dealing in them. LR 5.2.2 G gives examples of these situations when:

- 1) the securities are no longer admitted to trading as required by these rules;
- 2) the issuer no longer satisfies its continuing obligations for listing, for example, if the percentage of shares in public hands falls below 25% or such lower percentage as the FCA may permit;
- 3) the securities listing has been suspended for more than six months;
- 4) the securities are equity shares with a standard listing issued by an investment entity where the investment entity no longer has a premium listing of equity shares.

The Kuwaiti legislation provides six grounds for cancellation:

- (a) if a decision was issued to liquidate and dissolve the company;
- (b) where a merger process leads to the disappearance of the legal personality of the company;
- (c) if the company requests cancellation;
- (d) if the company stops its activity;
- (e) if the company has lost a condition of listing requirements;
- (f) if the suspension continues for a period of six months with no suitable measures taken by the company to continue trading.⁴⁷

⁴⁷ Kuwaiti Resolution No. 3 2011 Article 25.

The final ground is the most important. It links the suspension and cancellation, which means that if the Authority finds a good reason to cancel any listing company, except on the previously stated grounds, the Authority must use its power to suspend the company for six months. The suspension is essentially an initial warning.

Under the Saudi legislation, the Saudi Authority has more power in terms of cancellation than the Kuwaiti Authority in that, at any time, the Saudi Authority may cancel the listing of a company as it deems fit, including, as set out in one of the general provisions, to protect investors and to preserve the stability of the market.⁴⁸ The same situation exists in Qatar, where Article 66 of the Offering and Listing Rulebook of Securities 2010 gives three examples of cancellation, after which it states generally that the Qatar Financial Markets Authority may cancel the listing on any other grounds regarding the public interest or investor protection. In these three countries, the power to cancel rests with the authorities, but the situation is different with regard to suspension, because Kuwait's legislation empowers both the Kuwait Capital Authority and the Stock Exchange to suspend temporarily.

4.3.2.2 Suspension

Suspension means temporarily stopping a company's shares from trading in the stock market for an extended period of time. Suspension is used as one of the administrative sanctions.

The Saudi legislation mentions the cases of suspension and cancellation in the same Article 35 of the Listing Rules 2012 and also gives the Authority the power to select between cancellation and suspension in the same circumstances. Thus, the Authority has the freedom to suspend or cancel as it deems appropriate.

⁴⁸ Saudi Listing Rules 2012 Article 35.

In Qatar, the legislation discusses the cases of suspension differently. According to Article 63 of the Listing Rules 2010, the Authority has absolute power to suspend any company if the market is at risk or is likely to be at risk and if the suspension is important to protect investors. After that, the previous article gives examples of cases, but these are not in any way limiting.

The situation in Kuwait is complicated, because Act No 7 of 2010 gives the power of suspension to the Authority⁴⁹ and to the Stock Exchange⁵⁰ at the same time. This is an overlapping of mandates, which sometimes could cause difficulties although to date this has not occurred. If the period of suspension continues for six months, the company must take appropriate action during this period to resume its trading or the Authority may cancel the listing. The Kuwaiti legislation gives the stock market the right to cancel a listing indirectly by suspension for more than six months. Since overlap in the functions and responsibilities has the potential to cause future problems, it would be better if the Kuwaiti legislation gave the Authority the sole power to suspend without extending it to the Stock exchange as well.

In the UK, according to LR 5.1.1 R the FCA has a power to suspend any companies from listing if the smooth operation of the market is, or may be, temporarily jeopardised or it is necessary to protect investors. LR 5.1.2 G gives examples of these situations; for example when:

- 1) the issuer has failed to meet its continuing obligations for listing;
- 2) the issuer has failed to publish financial information in accordance with the listing rules;
- 3) the issuer is unable to assess accurately its financial position and inform the market accordingly;

⁴⁹ Kuwaiti Law No.7 2010 Article 147 part 1.

⁵⁰ *ibid*, Article 42.

- 4) the issuer has insufficient information in the market about a proposed transaction;
- 5) the issuer's securities have been suspended elsewhere;
- 6) the issuer has appointed administrators, receivers, or is an investment trust and is winding up.

In the UK, according to DTR 1.4.1, the FCA has the power to suspend any listed companies that do not comply with the Disclosure Rules, if there are reasonable grounds, such as a company's failure to make a required announcement and the failure has the potential to affect investor protection or the smooth operation of the market. Another clear example comes from DTR 1.4.4G when the issuer is unwilling or unable to publish a suitable disclosure within a reasonable period of time and there is or could be a leak of inside information.⁵¹ The FSA (now FCA) can also suspend securities from listing if that action is useful to protect investors according to LR5 (suspension, cancelling and restoring listing).⁵² Accordingly, under the listing regime, the company must provide the FSA (now FCA) with such information or explanation that it may require to protect investors.

4.4 What is Disclosure of Inside Information?

Chapter Three of this thesis (Insider Dealing) defined inside information clearly. This chapter will illustrate some examples of inside information and the extent to which the definition varies from country to country. For example, Kuwaiti legislation provides approximately 25 examples of inside information, after which it gives a general standard for determining inside information.

For the purposes of this thesis, disclosure of inside information means full, timely and accurate disclosure of information about a listed company's activities to provide equal

⁵¹ Louise Wolfson (n 22) 225.

⁵² Michael Blair QC, George Walker and Stuart Willey (n 41) 177.

opportunities of investment and to promote investor confidence and market integrity. Therefore, issuers⁵³ are required to provide investors with information that could affect their investment decisions, because such information can affect the prices of securities. The FSA (now FCA) Director of Enforcement and Financial Crime, Tracey McDermott, stated: ‘The integrity of our markets depends on listed companies making timely and accurate disclosures...’.⁵⁴ Examples of inside information that needs to be disclosed are material events, major changes in company policies, and decisions related to a major investment or capital purchase.

Ensuring that investors are sufficiently informed is one of the reasons for the regulatory intervention in financial markets that could help an investor to make a suitable investment assessment. The FSA (now FCA) Director of the Markets, Alexander Justham, stated: ‘JJB’s failure to disclose information...denied investors the ability to fully understand its financial position and make informed investment decisions’.⁵⁵ If the market fails to protect investors from making bad decisions because of inadequate or incomplete information, and if, as a result, investors lose confidence in the market, investors will withdraw from the market forever, and the market will suffer from reduced liquidity.⁵⁶

In most jurisdictions, there is a difference between immediate disclosure and periodic disclosure. For example, the Qatari legislation distinguishes between immediate disclosure⁵⁷ and periodic disclosure.⁵⁸ The former requires that information and events that may affect the securities prices must be disclosed without delay to the Qatar

⁵³ According to Article 1 of the Kuwaiti Disclosure Rules 2/2012, the issuer means a legal person (legal entity) whose security has been listed on a stock market.

⁵⁴ FSA/PN/024/2013; an enforcement decision was taken by the FSA.

⁵⁵ FSA/PN/015/2011; an enforcement decision was taken by the FSA against JJB Sports PLC, which was fined £455,000 for failing to disclose information to the market.

⁵⁶ Brian McDonnell (n 8) 3.

⁵⁷ Qatari Listing Rules 2010 Article 47.

⁵⁸ *ibid* Article 48.

Financial Markets Authority and the market. The latter requires that the listing companies prepare and publish financial periodic reports (quarterly, semi-annual and annual reports). However, in Qatar, Article 58 of the Listing Rules 2010 mentions the notifying of material events. The listing company has an ongoing obligation to notify the Qatar Financial Market Authority immediately of material events, such as suspension or cancellation in a foreign stock exchange, liquidation and dissolution of the company, the filing of any lawsuit by or against the company, etc. The Qatari legislation deals with the disclosure of inside information by giving examples of the material events without mentioning a general standard by which to identify inside information. However, more recently in Article 1 of Law No 8 of 2012 regarding the Qatar Financial Markets Authority, Qatar legislation defines inside information as information that is not made public. However, this is an incomplete definition, because some information does not affect the prices of shares.

In the Saudi Market, in terms of material developments, an issuer must disclose the material developments to the Authority and the public without delay. Article 41 of Listing Rules 2012 defines the material developments that must be disclosed as any developments regarding the issuer's activities, non-public knowledge, having the potential to affect its assets and liabilities or financial position or the general course of business of the company or its subsidiaries. In addition, these developments may change the securities' prices and may affect the investors' decisions. Part (b) of the same article provides a number of examples of material developments, which are not limited to the buying or selling of an asset or any losses equal to or greater than ten percent of the net assets of the company, changing the directors or executives of the company, etc.

In Saudi, Article 26a of the Listing Rules 2012 gives the Authority the right to require any further information or to impose additional continuing obligations if it deems this appropriate. However, the Authority must notify the company and give it the opportunity to present its opinion before imposing any obligations or requirements.

4.5 Control of the Disclosure

Several obligations are related to disclosure of inside information during the listing period, in terms of the type of information and the timing of its release. . Therefore, the questions here are: how to define the inside information and what is a suitable time for disclosure?

This discussion reveals a number of criticisms of the system of disclosure of inside information which affect competition, because early disclosure can reveal the company's plans and future projects to a competitor in the market. In addition, in practice, there is difficulty in identifying inside information because of the lack of an accurate standard and because issuers can differ in their understanding of fundamental information.

It is a difficult challenge to identify material (inside) information and to determine the appropriate time to announce it. For example, in Kuwait, a seminar organised by the Kuwaiti Capital Markets Authority (KCMA) related to the disclosure of inside information was attended by a large number of legal advisers of listed companies and compliance managers from the Authority. A number of participants in the seminar expressed dissatisfaction because of the many grey areas that were in the answers given by the Authority officials present. KCMA officials stressed the need for the immediate disclosure of inside information. This was the subject of controversy when the audience asked about one of the criteria that determined what information is material. The Authority replied that this is determined by the issuers. Every piece of information that has an impact on the financial position is essential. Commission officials stressed that any information that can lead to a change in the share price and trading volumes requires disclosure, even if it is secret or if the company is in the process of completing some of the agreements, for example, if a company has signed a confidentiality agreement to restructure or study something with any of the consulting houses. The officials emphasised the need to disclose to the Commission and the Stock Exchange before publishing the announcement in the newspapers and the media in general or on the company's website. One member of the audience complained that the Authority laid

down harsh sanctions despite having failed to set accurate and clear standards to identify inside information. One attendee expressed dismay, because these requirements, which require revealing to a competitor important information about pricing and secrets about the other company, may prove unfair to listed companies as most of their competitors are not listed in the Stock Exchange.⁵⁹ So this is a disadvantage of listing.

In Kuwait, prior to 2012, the situation was addressed only under the Listing Rules, especially according to Article 13, which mentions that members of the board of directors of the company must provide all of the information and data required by the Authority. The Stock Exchange and either the Authority or the Stock Exchange can select the inside information, the nature of the information, and the time of disclosure, which can lead to an unclear definition of material information. However, in 2012, the Kuwaiti legislature passed new disclosure rules 2/2012 that were supposed to fix these problems. This will be discussed later.

In the UK, the disclosure should be made as soon as possible, and there should be legitimate reasons for any delay in making the disclosure. Therefore, it is unacceptable to delay the announcement because of a delay in obtaining approval from the board because the company is preparing the announcement, or because the presentation to analysts is not ready.⁶⁰ A timely disclosure is very important even though a listed company feels that delaying the disclosure will reduce its impact. This can be clearly seen from the FSA (now FCA) enforcement decision in 2009 against Entertainment Rights plc, which was fined £245,000 for failing to disclose inside information in a timely manner with a 78-day delay in breach of disclosure rule 2.2.1 and listing principle (LP) 4. Entertainment Rights plc entered into an agreement in the US in 2006 to distribute DVDs in the US. In July 2008, a variation to the agreement reduced the company's profits by US \$13.8 million. This variation was inside information that would have had a material impact on share price. Inside information must be disclosed

⁵⁹ <<http://www.alqabas.com.kw/node/735010>> accessed 29 January 2012.

⁶⁰ 'Technical note: Disclosure and transparency rules: UKLA' (Financial Services Authority) 4; It is not binding. It serves as an explanation.

as soon as possible. Thinking that it had a chance to reduce the effects of this inside information in the future, the company delayed the announcement until September 26. As a result its shares declined by 55 per cent that day.⁶¹

Assessing what constitutes inside information is not straightforward, because it depends on different factors, such as changes in the issuer's business, operations and capital. The issuer is best placed to determine whether inside information exists that could significantly affect securities prices. Therefore, the best solution for controlling the disclosure of inside information is to make an issuer responsible for a disclosure in a way that can be clearly seen from the listing principle in the UK, which mentions that adequate procedures, systems and controls must be established by an issuer (Listing Principle 2) to comply with its obligations.

4.6 Delay and Extent of Disclosure

The next section is a discussion of delay in full disclosure, limited disclosure, initial and final disclosure and exemption from disclosure.

4.6.1 Delay in Full Disclosure

In the UK, companies are allowed to delay their public disclosure of inside information if a number of conditions are met in certain circumstances according to the Disclosure and Transparency Rules (DTR) 2.5. Disclosure may be delayed to protect the legitimate interest of the company⁶², if it is not misleading to the public, or if a duty of

⁶¹ FSA/PN/015/2009; an enforcement decision was taken by the FSA.

⁶² Example of the situations where disclosure might be delayed to protect the legitimate interests of the companies are provided in DTR 2.5 as

- Negotiations in course, or related elements, where the outcome or normal pattern of those negotiations would be likely to be affected by public disclosure.
- Impending developments which could be jeopardised by premature disclosure

confidentiality is owed to the issuer by whomever is receiving the inside information, and confidentiality is ensured by the issuer. Under no circumstances may the delay be based upon negative news, such as a financial difficulty. However, DTR 2.5.5AR allows a delay due to negative news if it is related to liquidity support from the Bank of England or another central bank.⁶³ Therefore, either negative or positive news must be made public as soon as possible. This point is supported by the Managing Director of the Wholesale and Institutional Market at the FSA (now FCA), who said that ‘it is unacceptable for a company not to disclose negative news, because it believes other matters are likely to offset it. Doing this hampers an investor’s ability to make informed investment decisions and risks distorting the market value of a company’s shares’.⁶⁴

An example of positive and negative disclosure can be found in the FSA enforcement decision in June 2010, when Photo Me International plc was fined £500,000 for disclosing inside information 44 days late. In late 2006, Photo Me announced positive news about winning large sales contracts, as a result of which its share prices jumped. However, in January 2007, Photo Me learned that at least five other competitors were engaged in contract negotiations for the sale of a lot of minilabs. This was inside information that Photo Me was obliged to disclose as soon as possible. In addition, in February 2007 Photo Me could not reach its announced sales targets of 1,100 minilabs from 2006 to 2007, and forecasts were revised down by 40 per cent. Thus, it expected to sell 750 fewer minilabs during that period. This was also inside information that Photo Me was obliged to disclose as soon as possible under DTR 2.2.1 and listing principle 4. The inside information was closely monitored until the scheduled quarterly board meeting on 1 March 2007, when this was discussed. The day after the announcement, the price of its shares decreased by 24 percent.⁶⁵

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- The provision of liquidity support by the Bank of England or by another central bank.

⁶³ Louise Wolfson (n 22) 240.

⁶⁴ FSA/PN/011/2009; an enforcement decision was taken by the FSA regarding Wolfson Microelectronics plc (Wolfson).

⁶⁵ FSA/PN/102/2010; an enforcement decision was made by the FSA

In Kuwait, if inside information is delayed due to ongoing negotiations that have not yet been resolved, or if there are contracts or agreements requiring accreditation from another party to become effective, an issuer has the right to request a delay of disclosure from the KCMA, if there is no possibility of misleading the public and there is a guarantee from the issuer that the inside information will remain confidential.⁶⁶ There is no evidence on whether this request is usually granted or not.

According to Article 52 of Listing Rules 2010, the Qatari legislation allows the disclosure of information to be delayed under three conditions but there is no evidence of how this works in practice. The first condition is that the delay will not mislead the public. The second condition is that during the delay inside information will remain confidential. The third is that confidentiality of the information will be ensured by the issuer. Article 52 of the Listing Rules 2010 provides that the standard of postponement is to prevent damage to the company's legitimate interests, such as when public disclosure is likely to affect ongoing negotiations or related events. The Article gives another example when the board of directors makes decisions or enters into contracts that must be approved by another entity to become enforceable, and if the disclosure were to take place before the approval, it would hinder the public's ability to assess the information properly.

4.6.2 Limited Disclosure

Kuwait, Qatar, Saudi and the UK have a provision for limited disclosure in certain circumstances. Qatar's Article 53 mentions that limited disclosure, referred to as selective disclosure, is allowed in some circumstances for certain persons. However, it does not mention any other conditions, such as requiring selective persons to pledge to keep inside information confidential and banning dealing on the basis of this information until it is made public. This condition is found in Article 7 of the Kuwait Rules 2/2012. In Saudi law, Article 26(c) of the Listing Rules 2012 deals with this point

⁶⁶ Kuwaiti Disclosure Rules 2012 Article 5.

in the same way as Kuwaiti law. In the UK, companies are allowed to disclose inside information to a person⁶⁷ who owes a confidential duty to the issuer provided that other conditions are also met such as not breaching of other law and regulation. However, it is unacceptable to disclose inside information to journalists, for example, because they do not have a duty of confidentiality to the issuer.⁶⁸

4.6.3 Initial and Final Disclosure

If a serious and unexpected event occurs, and the company needs more time to understand the situation before making a disclosure, it can apply to the regulatory authorities for a temporary halt in trading or make an initial disclosure to be followed later by a full disclosure. Kuwaiti, Saudi and Qatari rules all allow for a temporary halt in trading, but Qatar has a provision for initial disclosure. The Qatari legislation defines initial disclosure in Article 51 of the Listing Rules 2010 and allows it under certain conditions. Sometimes, a serious and unexpected event can happen, the company needs more time before disclosing the situation, and there is a risk that inside information will leak out before disclosure occurs. Under these circumstances, the company may make an initial disclosure giving enough relevant details, explaining why it cannot publish all of the details, and pledging to disclose more details as soon as possible. In addition, the Article mentions that the company must request that the trading of its shares stop if it is

⁶⁷ The guidance in DTR 2.5.7 G (2) provides examples of the categories of recipients to whom a listed company might make selective disclosure of inside information as

- Its advisers and advisers of any other person involved in the matter in question
- Persons with whom it is negotiating, or intends to negotiate, any commercial, financial or investment transaction.
- Employee representative or trade unions acting on behalf of an employee
- Any government department, the Bank of England, the Competition Commission or any other statutory or regulatory body or authority.
- Its major shareholders
- Its lenders
- Credit-rating agencies.

⁶⁸ Technical note (n 60) 8.

unable to publish the announcement or if it declines to publish it. Furthermore, according to Article 4, part 3 of the Kuwaiti Disclosure Rules, if something unexpected, sudden or significant happens, an issuer may request an interim cessation of dealing if the issuer wishes to delay the disclosure for a short period. Saudi Article 37 provides that a temporary trading halt may be requested by an issuer in certain circumstances when an event happens during trading hours, and the issuer cannot keep the confidentiality of information until the end of the trading period.

4.6.4 Exemption from Disclosure

Some legislation exempts a company from disclosure in certain circumstances. For example, in Qatar, exemption from disclosure of information is discussed in Article 54 of Listing Rules 2010, which provides that the Qatar Financial Market Authority may accept non-disclosure of some information, such as when this kind of information would not damage or affect the investor's knowledge about assessing the cost, benefits and investment risk. Other examples are when the disclosure is likely to affect the issuer's interest and when the public interest is expected to be affected by the disclosure. There is no mention of what constitutes the public interest. In addition, Article 54 provides for obligations after approval of the non-disclosure of information. First, the issuer must control the information and limit its scope as much as possible. Second, any person who might know about this information shall not use it or disclose it to another person without written acknowledgment from that person that he shall not use the information for personal interest and shall not disclose the same to others. Third, the issuer must monitor the trading of any person who may know about this information and the trading by their relatives or others with whom the person has a close personal, commercial or financial relationship.

It is a vague and strange text, because if information does not affect the prices of shares and is therefore not inside information, why is there an exemption? In addition, it is illogical to prevent disclosure because of negative news, because positive and negative news must be disclosed. The same posture appears in Article 26, part D of the Saudi

Listing Rules 2012, which provides that the company may request exemption from public disclosure, if the disclosure would harm the company, and the disclosure is not expected to mislead the investors. However, in this case, the issuer must notify the Authority in a strictly confidential way about the information and with the objective of maintaining the information undisclosed in this period.

4.7 Dealing with Rumours

The greater the delay in disclosure of the correct information the higher the risk of rumours. The disclosure rules also deal with rumours and false information which may arise as a result of a delay in disclosing the correct information. For example, in the foregoing circumstances the UKLA may ask the issuer to disclose inside information or to establish the truth.⁶⁹ Otherwise, under DTR 1.3.3, the UKLA can use its powers to require the issuer to publish inside information to protect investors or to ensure the smooth operation of the market. The UKLA can also suspend an issuer's securities from trading if the issuer refuses to disclose inside information.⁷⁰ On the other hand under DTR 2.7 the issuer has an obligation to take appropriate action if there is press speculation and market rumours. This means that the issuer has to judge whether it needs to make a disclosure under DTR 2.2.1. The question here is whether such disclosure to make an announcement needs to be in a formal way. The UKLA usually does not require such an official announcement in the event of a rumour. However, in practice, if the announcement has the potential to affect the issuer's share price it would be better to make a formal announcement.⁷¹

In Kuwait, an issuer should immediately clarify, confirm or deny, without any delay, when there is speculation, news or current information related to the issuer's shares that is likely to affect the prices of its securities or is linked to the investment decisions of

⁶⁹ *ibid* 1.

⁷⁰ *ibid* 2.

⁷¹ *ibid* 9.

traders, regardless of whether the information is true or false.⁷² Here, if the unusual trading does not stop, the Kuwait Authority has the right to impose a temporary suspension of trading.

In Qatar, if the same situation occurs, the issuer should only disclose at the request of the Qatari Authority, so disclosure is not a direct obligation of the issuer. This means that the Authority is supposed to monitor all securities trading and cannot rely on disclosure by the issuer.⁷³ This is very different from the UK.

Sometimes, some people may take advantage of a rumour that is the result of the lack of clear disclosure or of leaks. This can cause unusual trading activity. For example, in Kuwait, if unusual trading occurs the issuer must take one of the following actions:

- (a) re-disclose inside information if the issuer determines that it happened as a result of a previous disclosure;
- (b) consult with the Authority if an issuer believes that it happened as a result of the absence of interpretation or a misunderstanding;
- (c) comment immediately without delay if there are rumours;
- (d) disclose inside information if there are leaks of information;
- (e) make a general announcement, including that nothing new has happened, if the issuer does not find the reason for the unusual trading.

Therefore, the Authority could apply a temporary suspension if the issuer could not fix the unusual trading.⁷⁴

⁷² Kuwait Disclosure Rules 2/2012 Article 6.

⁷³ Qatari Listing Rules 2010 Article 56.

⁷⁴ Kuwait Disclosure Rules 2/2012 Article 6.

4.8 Improving the Disclosure Regime in Kuwait

Disclosure should empower investors and give them the opportunity to make an informed decision. It is not enough simply to draft disclosure rules. There also has to be a suitable mechanism for implementing them.⁷⁵ This is lacking in Kuwait in varying degrees and that could be improved by looking at the UK experience in this field. In the UK, several mechanisms exist namely the listing principles, director responsibilities, the insider list, the reasonable investor standard, the adviser and holiday disclosures which the Kuwait regime ought to adopt.

4.8.1 Listing Principles

In the UK, all listed companies with a premium listing of equity shares are subject to the Listing Principles. The main objective of the listing principles is to aid listed companies in identifying their duties under DTR and Listing Rules.⁷⁶ None of the disclosure rules in Kuwait, Qatar or Saudi Arabia mention these principles. Listing principles are a part of the listing rules, and if they are breached, the FSA (now FCA) can apply disciplinary action against the listed company. However, investors cannot take any action against a listed company when it breaches the listing principles.⁷⁷

The three most important listing principles related to this thesis are Principles 1, 2, and 4.

- Listing Principle 1 relates to ‘reasonable steps’ to make the directors of the issuer aware of their responsibilities and obligations. For instance, receiving suitable continuing training to understand any change or update of listing rules or DTRs is one way to achieve the goal of Principle 1.⁷⁸

⁷⁵ Niamh Moloney, *How to Protect Investors: Lessons from the EC and the UK* (CUP 2010) 300-301.

⁷⁶ Louise Wolfson (n 22) 284.

⁷⁷ *ibid.*

⁷⁸ *ibid* 285.

- Listing Principle 2 sets out adequate procedures, systems and controls to be taken by an issuer in order to fulfil its obligations in an appropriate way. The two most important points are when such an obligation arises and how to achieve a timely and accurate disclosure. Directors must take reasonable steps to control the flow of the information in addition to assessing its significance according to Listing Principle 2.
- Listing Principle 4 covers avoiding establishing false market information by communicating to holders and potential holders of shares.

Recently, the FSA (now FCA) has placed more emphasis on the application of these principles. In 2013, the FSA (now FCA) fined Lamprell plc £2,428,000 for systems and controls failings. The company breached Principle 2, because it was unable adequately to monitor its financial performance, and it did not keep the market completely informed of its deteriorating financial position.⁷⁹

4.8.2 Directors' Responsibilities for Controlling Disclosure

There are two important points concerning how to control inside information. The first is how to determine that the information is inside information. The second is how to establish a suitable time for the disclosure. Making a limited group from the board of directors responsible for releasing inside information to the public could improve the situation and could make it highly susceptible to control.

In the UK, this responsibility is frequently delegated by the issuer's board of directors to a small group of directors, because they can deal with it quickly. Nevertheless the whole board remains responsible as a matter of law and as a matter of regulatory responsibility and under the listing rules. Principle 1 of the Listing Rules in the UK was created to make the directors responsible for the disclosure aware of their obligations (Principle 1). Thus, the rest of the board should not communicate with the press, analysts or investors

⁷⁹ FSA/PN/024/2013; an enforcement decision was made by the FSA in 2013.

or talk about information if they are not aware of the issuer's policy of inside information and they are not authorised to be responsible for identifying, controlling and disseminating inside information. This is a serious problem, which the issuer should face.⁸⁰

Also in the UK, Listing Rule 9.2.11R mentions 'the contact person', which means at least one suitable person (with knowledge about the company) who updates the contact with the FSA (now FCA) and whom the issuer must nominate as the first point of contact with the FSA (now FCA) regarding listing rules and DTRs.

In Qatar, Article 55 provides that the issuer is responsible for three aspects of disclosure. The first is accuracy; the second is the authenticity of contents; and the third is the time when information should be disclosed. In addition, the same article provides that the Authority is not responsible for any of these three aspects. Therefore, the Qatari legislation sets a clear responsibility for the accuracy and timing of disclosure. The legislation does not specify how this works in practice.

In Kuwait, the general requirement in the applications for listing is that the company's board members must pledge to adhere to all of the rules and regulations set by the Stock Exchange and to provide the Authority and the Stock Exchange with all of the required data and information, provided that the information is correct and reliable according to

⁸⁰ The FSA (now FCA) confirmed this by saying:

In our experience, a number of problems and uncertainties that issuers have faced in handling inside information have arisen because they have not identified...those employees who are responsible for communication. If a few employees who are aware of the issuer's policy and the legal and regulatory requirements are clearly identified to all staff, senior management should be better able to control the dissemination of information and reduce the chance of unauthorised or careless disclosure. Staff should be prohibited from communicating information to outside the issuer if they have not been given this responsibility. Issuers may find it helpful to identify employees responsible for communication to analysts and the press. Issuers might also consider making their internal policies on communication known outside the issuer. This may particularly help staff avoid being pressured to prematurely reveal confidential information. Technical note (n 60) 3

Article 13 of decision No 3 of the Kuwaiti Disclosure Rules 2012. Article 3 of this rules states that the issuer is responsible for the disclosure and for selecting the appropriate time for the disclosure. In practice, it would be better if the responsibility for both disclosing and deciding a suitable time for the disclosure were limited to a small group of the issuer's directors, who have ongoing training and are aware of updated disclosure rules.

4.8.3 Insiders' Lists

In the UK, the issuer has to provide the FSA (now FCA) with an insider list detailing the persons who have access to inside information (DTR 2.8). The issuer must keep this list ready and when the FSA (now FCA) requests it, the issuer must provide this list as soon as possible. In the UK, 'as soon as possible' means without delay.⁸¹

Any person working for the issuer with access to inside information directly or indirectly and anyone acting on behalf of the issuer is an insider and must be listed. The issuer must keep the list for at least five years (DTR 2.8.5 R) and it must include the identity of each person, why he or she is on the list, and the date on which the insider list is updated (DTR2.8.3R). The list must be immediately updated with any change about the insiders (DTR 2.8.2 R). This list should include how the person became an insider in order to monitor and regulate the person's activities, because it is difficult to ensure that insiders and investors have equality of information at the same time.

In theory, some people have access to inside information, but should not be included in the insider list. For example, the issuer may employ an adviser to help the issuer to determine whether information has reached the level of inside information, or to provide assistance if an issuer does not know how to apply the Disclosure and Transparency

⁸¹ Michael Blair QC, George Walker and Stuart Willey (n41) 198.

Rules or Listing Rules. The adviser may employ someone to do photocopying. This person should not be included in the list of insiders.⁸²

Having an insider list is better than preventing directors and senior executives from trading. Although both would achieve the same goal, the latter is more restrictive and less effective. Saudi legislation adopted the latter approach in Article 50 of Listing Rules 2012 by banning certain position holders from dealing in securities for a period of time. The directors and senior executives of the company and any person related to them are banned from dealing in securities for fifteen days before the end of the financial quarter until publication of the information. They are also banned during the thirty days before the financial year until the company's annual financial statements are published.

Qatari legislation in Article 49 of Listing Rules 2010 gives the Qatari Authority the right to determine the period of the ban. The directors of the board and the executive officers of the company are prohibited from dealing, directly or indirectly, in any securities of the company. No specific time is specified for the ban, which is instead left to the discretion of the Authority.

It would be better if Saudi and Qatar were to request issuers to prepare a list of insiders instead of relying on Articles 50 and 49 respectively. Kuwaiti legislation too should consider adding such a requirement to its disclosure regime.

4.8.4 An Adviser

In the UK, an issuer can use an appropriate adviser to consult about any information, especially to know whether the information reaches the level of inside information. The

⁸² Technical note (n 60) 10.

FSA (now FCA) does not specify a particular type of adviser,⁸³ and companies cannot rely on the adviser's opinion to determine whether information needs to be disclosed. This can be clearly seen from the FSA's (now FCA) enforcement of its decision regarding Wolfson Microelectronics plc (Wolfson), which the FSA (now FCA) fined £140,000 for delaying the disclosure of inside information for 16 days, although its investor relations adviser had erroneously advised that negative news did not have to be disclosed.⁸⁴ The Managing Director of Wholesale and Institutional Markets at the FSA (now FCA), Sally Dewar, supports this point by saying that 'companies have the primary responsibility for meeting their disclosure obligation... they cannot rely ... on such advice'.⁸⁵

Kuwait, Qatar and Saudi have no mention in their rules regarding how to use an appropriate adviser to consult about any information.

4.8.5 The Reasonable Investor Standard

According to DTR 2.2.4G (1), an issuer must take into account the reasonable investor standard when determining whether the information is price sensitive; in other words, whether the investment decision of a reasonable investor would be significantly affected by undisclosed information if it were made public knowledge. In the David Massey case it can be seen that the Upper Tribunal took the reasonable investor test into account when it upheld an enforcement decision made by the FSA (now FCA) to impose a penalty of £150,000 against Mr. Massey.⁸⁶ Mr. Massey made a short sale of £ 2.5 million in an Alternative Investment Market (AIM) listed company of which he had been a former corporate financial adviser. In order to meet his obligations under the

⁸³ *ibid* 4.

⁸⁴ FSA/PN/011/2009; an enforcement decision was taken by the FSA against Wolfson Microelectronics plc (Wolfson).

⁸⁵ *ibid*.

⁸⁶ 49(TCC) UKUT [2011] Upper Tribunal reference FIN/2009/0024.

short sale, he realised a net profit of £100,000, he subscribed to 2.5 million new shares at a greatly discounted price. The FSA claimed that he made the short sale on the basis of inside information that was readily available to him regarding the imminent issue of discounted shares to him. The Upper Tribunal believed that this kind of information would influence a reasonable investor by saying that ‘Information would be likely to have a significant effect on price if and only if it is information of a kind which a reasonable investor would be likely to use as part of the basis of his investment decision’.⁸⁷

This evaluation is broadly different from one issuer to another, because in fact it depends on different factors, such as the sector, the issuer’s activities, and the reliability of the sources of information.⁸⁸

Kuwaiti disclosure rules 2/2012 have taken a prudent person standard to determine inside information. The standard is defined as a person who seeks to maximise his benefits if he can use the inside information when making his investment decisions. Disclosure rules emphasise that a prudent person standard varies from one investor to another depending on several factors, such as the issuer’s size, recent developments, the general situation of the market, and in particular the issuer’s sector.

4.8.6 Weekend Disclosure

During the weekend, the UK stock exchanges are closed. So there have to be special provisions to deal with this. In the UK, there is what is known as the ‘Friday Night Drop’ case. The name comes from the fact that when a Regulatory Information Service (RIS)⁸⁹ is closed on Friday evening, the permitted delay in disclosure to the authorities

⁸⁷ *ibid.*

⁸⁸ Louise Wolfson (n 22) 228.

⁸⁹ RISs are the places that must disseminate inside information on behalf of listed companies after receiving the information on the full text of the regulatory disclosure, and after the disclosure has been approved by the FSA.

is until the RISs reopen on Monday morning. However, over the weekend the information must be made public by the company in one newspaper.⁹⁰ This situation is not clear in Kuwait, Qatar and Saudi Arabia.

In Saudi Arabia, the subject of disclosure is dealt with differently. Article 40 provides for the conditions that must be met when disclosing. The disclosure of information or material developments must be clear, fair, and not misleading. It should also be made public at least two hours before the start of the trading period. A company must immediately disclose an event that occurs during trading hours, and it cannot keep information confidential until the end of the trading time. The company can request a temporary trading halt from the Authority, which may accept or reject the request at its discretion.⁹¹

Article 4 of the Kuwaiti Disclosure Rules states when the disclosure should take place. It provides that the disclosure should occur immediately without delay during the trading time or before a dealing session. However, unlike the UK, there is no provision for holiday time.

4.8.7 Form of the Disclosure

Since Qatar's Article 47 does not require a written form of disclosure, it allows any means available. A written announcement helps to explain the information and to provide clarity. Saudi and Kuwaiti laws do not require a special method of disclosure. It would be better if they required a written form for the disclosure. In the UK, regulatory disclosure must be written.⁹²

⁹⁰ Technical note (n 60) 8.

⁹¹ Saudi Listing Rules 2012 Article 37.

⁹² Technical note (n 60) 2.

4.9 Sanctions for Failure to Disclosure

Since laws must provide a regime to punish those who breach the information disclosure regime, the civil liability, the criminal liability and the administrative sanctions available must be considered.

4.9.1 Administrative (civil) fines

In the UK, the FSA (now FCA) can impose administrative sanctions in the form of a fine, a public censure. Under s118 of the Financial Services and Markets Act 2000 (FSMA), the FSA (now FCA) can impose civil sanctions if the disclosure takes the form of market abuse. This regime also deals with misleading statements and practices. S118 (c) defines inside information as follows. Unless the rules permit delay, an RIS must be notified by issuers about inside information as soon as possible if the information concerning the issuer⁹³ is of a precise nature,⁹⁴ has significant effect,⁹⁵ and differs from issuer to issuer depending on different factors, such as recent developments and the issuer's size.

In the UK, the FSA (now FCA) adopted a new policy in 2010⁹⁶ regarding the enforcement of financial penalties, as the result of which the amount of fines increased.

⁹³ Michael Blair QC, George Walker and Stuart Willey (n 41) 197.

⁹⁴ s118 (d) states:

information is precise if it (i) indicates circumstances that exist or may reasonably be expected to come into existence or an event that has occurred or may reasonably be expected to occur, and (ii) is specific enough to enable confusion to be drawn as to the possible effect of those circumstances or that event on the price of qualifying investment or related investments.

⁹⁵ According to s118(d), 'information would be likely to have a significant effect on price if it is information of the kind which a reasonable investor would be likely to use as part of the basis of his investment decisions'.

⁹⁶ <http://www.fsa.gov.uk/pages/Library/Policy/Policy/2010/10_04.shtml> accessed 9 June 2015

This was evidenced by the enormous size of the enforcement decision in 2013 against the Prudential Group which was fined £30 million for breaching FSA (now FCA) principles and UKLA listing principles.⁹⁷ The new policy is based on income. The penalty will be up to twenty per cent of a firm's revenue from its business area and products. The penalty imposed on individuals who breach regulations in non-market abuse cases will be up to forty per cent of the individual's benefits and salary. The penalty in cases involving serious market abuse by an individual is a minimum of £100,000.⁹⁸ This policy seeks to achieve three objectives: disgorgement, deterrence and discipline.⁹⁹ Its purpose is to change the behaviour of the market, as pointed out by Margaret Cole, FSA (now FCA) Director of Enforcement and Financial Crime, who stated that 'we believe enforcement penalties are a powerful tool to help change behaviour in the industry'.¹⁰⁰

In Kuwait, the KCMA can apply one of the administrative penalties included in Law No 7 2010 if the issuer does not comply with the Disclosure Rules.¹⁰¹ However administrative penalties do not include fines.

Article 80 of Qatar Listing Rules 2010 provides that any person violating these rules will be punished with any of the administrative penalties according to the Qatar Authority Law. The Saudi listing rules make no provision for punishing breaches of the listing rules.

4.9.2 Criminal Sanctions

⁹⁷ FSA/PH/031/2013; an enforcement decision was made by the FSA against Prudential Group PLC.

⁹⁸ < <http://www.fsac.org.uk/library/communication/pr/2010/036.html> > accessed 13 June 2015

⁹⁹ *ibid.*

¹⁰⁰ *ibid.*

¹⁰¹ Disclosure Rules 2/2012 Article 12.

With regard to regulations about the disclosure of inside information required of listing companies, some companies could make such a disclosure wrongly by including false or misleading information or by omitting information.

In the UK, under s397 of the FSMA 2000, false disclosure can lead to a criminal offence when it creates a false impression in the market (misleading statements and conduct), which is punishable by up to seven years imprisonment or an unlimited fine. In 2005, Bailey, who was the chief financial officer, and Rigby, who was the chief executive officer of AIT Group Plc, were convicted of misleading, false and deceptive conduct under FSMA s397. They were sentenced to nine months and eighteen months in prison, respectively.¹⁰²

In Qatar, a criminally responsible person shall be punished in accordance with Article 40 of Law No 8 of 2012 regarding the Qatar Financial Authority, part 4, if he or she has presented incorrect data, information or statements to influence the market transactions and if, according to part (7), he or she omitted, withheld or prevented material facts for which the law requires disclosure to the Authority. In Saudi Arabia, the situation is dealt with by Article 56 of the Capital Law which provides for the responsibility of ongoing obligations and civil liability¹⁰³, but does not include a criminal penalty.

In Kuwait, for criminal liability, a fine of a minimum of 1,000 but not exceeding 100,000 KD, but no imprisonment, is imposed upon any person who has omitted,

¹⁰² *R v Rigby and Bailey* (2005) EWCA Crim 3487.

¹⁰³ In Saudi the scope of this responsibility includes any person who makes, or who is responsible for another person who makes, an untrue statement of material fact or omits material facts, whether orally or in written statements. He shall be liable for compensatory damages if the wrongdoing misleads another person in relation to buying or selling securities without the requirement of a relationship between the two parties. However, the claimant must prove first that he was not aware that the statement was untrue or omitted and, secondly, that he would not have sold or purchased if he had known about the information. Thirdly, the claimant must also prove that the person responsible for the disclosure knew about the untrue information included in the statement or was aware of the important material fact that was omitted. The third condition regarding the disclosure of false information seems to impose an unrealistic requirement that is almost impossible to accomplish, and it would be better if the burden of proof in this instance were on the Authority, because the Authority has powers of investigation, or alternatively the issuer has to prove that he did not know that the information was untrue. In addition, in same law subsequently provides that liability ends one year after the claimant becomes aware of the facts causing his loss or five years after the violation occurs.

withheld or prevented material information for which the law required disclosure to the Authority or Stock Exchange regarding dealing or advising about selling or buying securities.¹⁰⁴

4.10 Conclusion

This chapter has dealt with the protection of investors from the perspective of the disclosure regime under the 2010 Act. To be protected, individual investors must have fair disclosure. Enhancing the disclosure regime mainly relies on rule-making, which is part of securities law. Disclosure is a positive action. Consequently, a firm that fails to disclose could face administrative sanctions even if the firm did nothing else wrong.

There is an overlap between disclosure and listing rules. Listing rules are agreed by a listed company and a stock exchange. International competition can affect the responsibility for regulating the stock exchange. This chapter has also examined the disclosure regime in Kuwait and compared it with the situation in the UK, Saudi Arabia and Qatar. In Kuwait, the 2010 Act does not empower the Kuwaiti regulatory authority to pass fines, which makes the disclosure regime less effective. In the UK, the FCA can pass unlimited fines.

It is difficult to assess what inside information needs to be disclosed and when. In some cases, the disclosure of such information can legally be delayed, limited or exempted. In addition, there is a relationship between rumours and disclosure rules. All of these require rules to regulate them. This chapter has found that a disclosure regime is a complicated subject, because many rules are related to disclosure; rules need to be updated over time, and some rules can affect stock market competition. Fair disclosure cannot be achieved without having sound regulatory authority, as will be discussed in Chapter Six.

¹⁰⁴ Kuwaiti Law 2010, Article 120.

By comparing the situation in Kuwait with the situations in the UK, Saudi and Qatar, a number of recommendations have been made that could improve the effectiveness of the disclosure rules in Kuwait, such as having listing principles, increasing each director's responsibilities and preparing lists of insiders. Kuwaiti securities law should give the regulatory authority the power to impose fines, which could play a significant role in enforcing disclosure rules.

Managers could disclose false information. In connection with this, the next chapter will discuss corporate governance principles that could help to protect investors.

Chapter Five

Corporate governance of listed companies

5.1 Introduction

The previous two chapters have dealt with the regulation of information which affects the buying, offering or selling of shares. However as early as the 1970 s (Maxwell, Guinness) a few corporate scandals started to emerge which highlighted the risk to an investor's shareholding from the irresponsible, negligent and even fraudulent or near fraudulent actions of those responsible for governing a company leading to a fall in company value and even its complete collapse.¹ This trend continued into the 21st century culminating in the 2008 financial crisis.² This chapter will consider the measures taken to regulate failures in Corporate Governance.

Is corporate governance part of securities law or is it part of a country's regulatory framework? The term Securities law suggests that this is a law about securities and it is. However it is not the only such law. There are corporate laws which also have a bearing on securities. Therefore when discussing securities it is preferable to use the term Regulatory Framework which encompasses different laws and secondary legislation all of which have a bearing on securities and holders thereof.

Corporate governance taken as a whole is definitely part of the regulatory framework. However corporate governance is not a monolithic structure. It has different facets to it and some facets may fall within the scope of securities law and others within the scope of Company Law (see chapter two 2.6.2), or other statutory instruments (listing and disclosure rules) and codes of practice. Corporate governance may be broken down into

¹ Bob Ticker, *Corporate Governance: Principles, Policies and Practices* (3rd edn, Oxford University Press 2015) 11

² *ibid* 15

a number of key areas or facets namely internal controls, institutional investment, role the effectiveness of non –executive directors, recruitment and development of non-executive directors, audit committees and board diversity.

In the 1990s a company’s responsibilities for these key areas were bundled into so called Codes which became part of a country’s regulatory framework for securities, complementing the existing components of that framework mentioned previously. In Kuwait Corporate Governance provisions became mandatory while in the UK some became mandatory and others discretionary on the principle of Comply or Explain.³

In the UK CG is very much within the regulatory framework in that it forms part of the DTR rules discussed in chapter 4. The CG requirement for audit committees (DTR 7.1) is subject to mandatory compliance while the remaining requirements (DTR 7.2) are discretionary.

Having good corporate governance is one way to protect individual investors by preventing and reducing the occurrence of company scandals in the future and ensuring that the company protects the value on behalf of shareholders. This chapter aims to answer the question about whether the 2010 Act protects investors from poor corporate governance of listed companies.

The previous two chapters dealt with insider dealing and fair disclosure.⁴ Good corporate governance can play a significant role in addressing both of these issues. However, the effect of good corporate governance is not limited only to these issues, because corporate governance is multi-faceted, and other aspects of corporate governance affect listed companies, such as risk management, bribery, fraud, and poor

³ Andy Ryde, Murray Cox, *The Corporate governance review* (editor Willem Calkoen, 5th edn, Law Business Research Ltd 2015) 411

⁴ Sometimes there is an overlap between disclosure rules and the applicable corporate governance code. For example, in the UK, DTR 7.1.3 R ‘sets out minimum requirements on composition of the audit committee or equivalent body’. In addition, provision C.3.2 of the corporate governance code ‘sets out recommended composition of the audit committee’.

board practice. In recent years, a number of scandals and collapses have not only reduced shareholders' financial investment, but have also affected other stakeholders, such as employees who have lost their jobs and, in many cases, their pension funds as well. Better enforcement methods of corporate governance compliance have the potential to reduce lapses of corporate governance and to boost investor confidence, economic efficiency and growth.

In companies in which ownership and management are separate, as in the case of listed companies, there is a danger that a director, by virtue of his powers, could put the company at risk or abuse his or her position.⁵ This is a worldwide problem, as illustrated by the examples below.⁶ Numerous scandals and collapses have occurred in different countries as a result of the shortcomings in the way that companies are operated. Therefore, it is clear that no country is immune from such problems, including Kuwait. Where gaps exist between owners and managers (separation of ownership and control),⁷ corporate governance principles can be used as one method of improving the

⁵ Erik Vermeulen, 'Beneficial Ownership and Control: A Comparative Study - Disclosure, Information and Enforcement' (2013) OECD Corporate Governance Working Papers 7, 8 <http://www.oecd-ilibrary.org/governance/oecd-corporate-governance-working-papers_22230939> accessed 9 September 2013.

⁶

Year	Country	Company
2001	US	Enron
2003	Italy	Parmalat known as Europe's Enron
2008	UK	Royal Bank of Scotland (RBS)
2009	India	Satyam
2012	Japan	Olympus Corporation

Christine Mallin, *Corporate Governance* (4th edn, Oxford University Press 2013) 2-7.

⁷ There are various theories about what corporate governance means, but the predominant theory is the 'agency theory', which considers the shareholders to be the principals and the directors to be their agents. Thus, there is a separation of ownership and control; (ibid 16-18).

performance of listed companies and therefore better protecting retail investors against the risk of poor corporate governance.⁸

The need for effective corporate governance rules is greater than ever before. The majority of such rules already exist in Kuwait, Qatar and Saudi, but they are not wide-ranging enough and have not always adequately protected investors. Securities law can play a significant role in improving corporate governance, because both effective enforcement and law are needed to protect investors. In other words, the securities law could enhance the enforcement of corporate governance principles which have the potential to protect investors.

It is unrealistic to try to fill these gaps with mandatory rules and regulations. A diversity of enforcement is required that is partly voluntary⁹ and partly mandatory, which is the approach adopted in the UK. Seventy countries have adopted corporate governance codes in some form or another.¹⁰

Good corporate governance does not only aim to protect investors, but it also has the potential to affect a company's overall success. Some say that there is a relationship between the success of the company and corporate governance. That is to say, that the

⁸ Qatar's Corporate Governance Code 2009 tries to explain this by saying that shareholders delegate powers to the board of directors, because in practical terms it is difficult for the shareholders to manage the company. The members of the board of directors delegate to executives the daily decision-making. As a result of these mandates, company executives have more power than members of the board of directors and shareholders, and they also have access to the important information in the easiest and quickest way. On the other hand, members of the board are in a better position to get important information and to control the company than shareholders. Thus, members of boards and executives may take advantage of this gap to achieve personal benefits at the expense of shareholders.

⁹ Such voluntary enforcement is generally referred to as 'comply or explain' and is underpinned by a regulatory framework that asks companies to send a report annually to the shareholders about the extent to which the principles have been adhered to and, if not, why not.

¹⁰ Brian Cheffins, 'Corporate governance LLM Cambridge, An introduction part 2 (3CL)' (Cambridge University iTunes).

more a company applies governance rules, the greater are the company's chances of success.¹¹ That success can protect investors in different ways, such as by keeping share prices stable. Corporate governance rules are designed to protect not only investors, but also nations, because the behaviour of companies influences our daily lives by promoting economic growth.¹² Consequently, some codes, such as the Kuwaiti Code 2013, require companies to exercise corporate social responsibility.

Corporate governance issues have attracted much attention in the last decade.¹³ Good corporate governance is established to prevent or reduce the occurrence of company scandals and collapses in the future. Therefore, the question is whether corporate governance in Kuwait is sufficient to protect investors against the people who control the company?

Although corporate governance principles differ from one country to another, good corporate governance is important for investor protection. Consequently, this chapter will define corporate governance and review some of its better known failures. It will consider some of the corporate governance principles in existence in the UK, Saudi and Qatar, and the enforcement methods in the UK, in order to compare them with measures in place in Kuwait with a view to determining whether the latter adequately protect investors.

5.2 What is Corporate Governance?

This chapter will look at the definition and the principles of corporate governance.

5.2.1 Definition

¹¹ Andrew Chambers, *Corporate Governance Handbook* (5th edn, Bloomsbury Professional 2012) 351.

¹² *ibid* 3.

¹³ Christine Mallin (n 6) 365.

Although the term ‘corporate governance’ is used every day in the financial press, it is a complex term, because it relates to various matters, such as law, economics, management, accounting and other subjects, and each field has its own developments. Corporate governance issues also include culture, ownership and legal arrangements.¹⁴ Therefore, defining corporate governance is not straightforward.¹⁵ There is no clear definition of corporate governance; it is multi-faceted. However, under the regulation of corporate governance, laws, rules and standards define the relationship between a company’s management on the one hand and shareholders and stakeholders, such as bondholders, workers, suppliers, creditors and consumers, on the other hand.

Since the first version of the UK Corporate Governance Code was produced the generally accepted definition in the UK has remained, the following which was set out in the UK Corporate Governance Code 2014:

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.¹⁶

From this definition, corporate governance is about the relationship between the board and the shareholders in governing and controlling the company

The GCC countries deal with the definition of corporate governance in different ways. For example, the Qatari legislature defines corporate governance as a system through which one can manage and control commercial companies in accordance with the Qatari Corporate Governance Code 2009. The rules of the QCGC determine the distribution of

¹⁴ Christine Mallin (n 6) 15.

¹⁵ Andrew Keay, *The Enlightened Shareholder Value Principle and Corporate Governance* (Routledge 2013) 6.

¹⁶ <<https://www.frc.org.uk/Our-Work/Publications/Corporate-Governance/UK-Corporate-Governance-Code-2014.pdf>> accessed 24 June 2015.

rights and responsibilities among the various stakeholders¹⁷ in the company, such as the board of directors and managers, shareholders and other stakeholders, and describe the rules and procedures for making decisions about the company's affairs. This is similar to the UK definition. However, the Saudi Code 2006 has no definition of corporate governance. The Kuwaiti legislature has defined governance in vague terms, stating that corporate governance is based on a set of rules that represent the foundation on which good governance practices in companies are based. These rules include a set of principles and methodology with the requirements needed to achieve the goals of governance. It seems that they define the code whilst trying to define corporate governance.

Although there is no fixed definition of corporate governance, the idea is based on two points. One is about control of the day to day operation and the other about the future direction of the business of the company. Controlling corporate governance can be likened to controlling a car, which involves controlling the steering wheel, the brake and the accelerator to ensure that the car reaches its destination.¹⁸ This means that corporate governance rules have the potential to define the authority, the approach to risk management, and how to protect a company and investors. Consequently, corporate governance is about the relationship between the boards and managers and between the boards and its investors by guiding company actions and monitoring their performance.¹⁹

5.2.2 Aim of corporate governance

¹⁷ In the stakeholder theory, the emphasis is not just on shareholders. The directors are seen as representing other groups. Stakeholders are any group or individual with an interest in the company's activities or performance, including suppliers, customers, employees, banks, shareholders, local communities, providers of credit, and government. Some stakeholders are related to the company directly, while others are related indirectly; Christine Mallin (n 6) 69-70.

¹⁸ Donald Nordberg, *Corporate Governance Principles and Issues* (SAGE 2011) 7.

¹⁹ *ibid* 5.

The objectives that the corporate governance codes seek to achieve vary from one country to another. According to the UK Code 2012, its goal is to deliver a company's long-term success by facilitating effective, entrepreneurial and prudent management. Corporate governance is about good management; it is not about the day-to-day operation of the company. It is about the board. The code is a guide to good management.

In Saudi Arabia, according to Article 1 of the Corporate Governance Code 2006, amended in 2010, the aim of the rules set out in section (a) is to guarantee the protection of the rights of the shareholders and the stakeholders. However, the Qatar 2009 Corporate Governance Code states that the goals of the corporate governance rules are to protect the company from one of the most important risks to which it may be exposed, namely the failure and shortcomings in its performance and the achievement of personal benefits.²⁰ In Kuwait, Resolution No 25 of 2013 places the issuing of corporate governance rules under the control of the Capital Markets Authority. It states the importance of establishing proper rules for corporate governance to achieve justice, competitiveness and transparency in the market. Rules of governance here are about principles, systems and procedures that better protect shareholders. In addition, they state that good governance is based on the promotion of three points. First, ethical behaviour to ensure commitment to ethics and good professional conduct; second, oversight and accountability and finally, administrative organisation to ensure the proper distribution of powers and responsibilities and the separation of functions.

According to Chambers 'Good governance means substance not just form, practices not just policies and performance not just conformance'.²¹ Thus, good governance requires performance and application, so that it is not just an expression.

²⁰ The Qatari legislature pointed out examples of the personal interests of the members of the board of directors and executives, such as the appointment of relatives and friends who are not eligible; receiving excessive wages, salaries, allowances, and other benefits; contracting business transactions with companies on unfair terms; and concealing, misleading or giving incorrect information to achieve a personal interest or to cover inadequate work, according to the Qatar Corporate Governance Code 2009.

²¹ Andrew Chambers (n 11) 349.

5.2.3 Corporate governance principles

A number of possible corporate governance areas have developed over time. These include board composition (leadership), board effectiveness, the role of board committees, risk management, remuneration, relationships with shareholders, bribery and corruption, IT governance, mergers and acquisition, succession planning, sustainability and climate change, and proxy access.

It is difficult to find fixed rules of governance that are suitable for every situation, because governance rules for protecting the nation differ from governance rules for shareholders and creditors, etc.²² Corporate governance needs to be developed over time. For example, in the UK, the Financial Reporting Council (FRC)²³ has stated that, even though the level of corporate governance standards is high, there still is room for improvement.²⁴ After the financial crisis of 2007/2008, Britain cannot say that its corporate governance is better than any other country's, although before the crisis it was arguable that the level of governance standards in Britain was better than anywhere else.²⁵ However, in the last ten years, corporate governance legislation has appeared in a number of countries to increase investor protection and confidence, especially in stock markets.²⁶

²² Donald Nordberg (n 16) 54.

²³ The Financial Reporting Council (FRC) is an independent regulatory in the UK. One of the FRC mission is to promote high quality corporate governance by setting the code and monitoring its impact. In 2003 the FRC took responsibility for the UK corporate governance code. The FRC's board comprise of 14 members some of them executive and some non-executive members. The board has three committees. The first one is the Code and Standards Committee which advises the board on matter relating to codes, setting standards and policy questions. The second one is Executive Committee which advises the board on matter relating to strategic issues and provides day-to-day oversight of the work of the FRC. The third one is Conduct Committee which advises the board on matter relating to conduct activates to promote high-quality corporate reporting. <<https://www.frc.org.uk/Home.aspx>> accessed 24 June 2015.

²⁴ Financial Reporting Council (FRC), 'Development in Corporate Governance 2011: The Impact and Implementation of the UK Corporate Governance and Stewardship Codes' (December 2011) 1.

²⁵ Andrew Chambers (n 11) 350.

²⁶ Christine Mallin (n 6) 26.

Corporate governance principles do not remain static, but evolve with the surrounding developments and must continue to develop. For example, the Organisation for Economic Co-operation and Development (OECD) issued Principles of Corporate Governance in 1999. The OECD governments agreed to revise new principles in 2004.²⁷ Ensuring the basis for an effective corporate governance framework, ensuring the equitable treatment of shareholders (including minority and foreign shareholders), protecting the rights of shareholders, disclosure and transparency, the role of stakeholders in corporate governance and the effective monitoring of and by the board (responsibilities of the board) are among the most important areas covered by corporate governance principles.²⁸

In the UK 2012 Code there are main principles, supporting principles and provisions. There are five main principles (A-E) pertaining to leadership, effectiveness, accountability, remuneration and relations with shareholders. Accordingly, the UK code is a guide to effective board practice. Each main principle has supporting principles, and each supporting principle has provisions. For example, provision A.2.1 states that the same person should not exercise the roles of chairman and chief executive. The letter A refers to the first main principle, which is the 'Leadership Principle'. The number 2 is about the second supporting principle, which is the 'Division of Responsibilities'. The number 1 refers to what action should be taken or not taken by the company to comply with the code. What compels listed company to comply with the code in the UK and the sanctions for failure to comply will be discussed later.

5.3 The Effect on investors of failures of corporate governance

There are different types of failure, such as poor risk management, fraud, fictitious transactions, corruption, financial manipulation (such as Libor manipulation), rogue trading and personal interest. The causes of the above problems are always due to

²⁷ Fianna Joesover and Grant Kirkpatrick, 'The Revised OECD Principles of Corporate Governance and Their Relevance to Non-OECD Countries' (2005) 3.

²⁸ *ibid* 7-9.

mismanagement. In the UK, many scandals have occurred; for example, those involving BAE Systems, BP, Barclays, GlaxoSmithKline, HSBC, HBOS, the Royal Bank of Scotland, Standard Chartered and the Natural Resources Corporation.²⁹ Barclays alone has been responsible for several corporate failures, including selling retail customers largely redundant Payment Protection Insurance (PPI), tax scams, shifting toxic assets off the balance sheet into a new company called Protium, secret payments to Middle East investors, the betrayal of corporate customers, hiding the movement of funds from Iran to the United States, poor investment advice, failing to provide accurate data, falsifying the Libor rate, inflating executive bonuses, mixing customer and proprietary assets and mis-selling interest rate swaps to small and medium-sized businesses (SMEs).³⁰

It is thought that the reason for the corporate scandals is the result of the hijacking of management theory from the main economic opinions in the 1980s, by focusing on increasing shareholder returns, such as large dividends, at the expense of retaining and reinvesting profits, including research and development, which caused false economic progress beginning in the 1980s.³¹ The failures were caused by management problems, not economic problems. As a result, corporate governance principles can be described as an intervention in the management of the company that aims to reduce the likelihood of such company failures.

One of the main influences that affect a company's future is high risk management, of which there are several examples. The BP oil spill is a good example of poor risk management. Known as the 'Deepwater Horizon disaster', the incident in April 2010 occurred because BP ignored standard safety procedures to decrease the cost of delay

²⁹ 'Britain's corporate failures invited a governance revolution' <<http://www.ianfraser.org/britains-scandalous-corporate-failures-invite-a-governance-revolution/>> accessed 25 October 2013.

³⁰ 'The 12 Barclays scandals that cast doubt on Diamond's testimony' <<http://www.ianfraser.org/move-on-you-crazy-diamond/>> accessed 28 October 2013.

³¹ Simon Caulkin, 'Management theory was hijacked in the 1980s' *The Guardian* (London, 28 June 2013) <<http://www.guardian.co.uk/commentisfree/2012/nov/12/management-theory-hijacked> > accessed 17 October 2013.

that would have been approximately \$1 million a day. The oil spill harmed shareholders, because the share price dropped dramatically, the company's profits declined and affected BP's employees, the environment, and the local community. Eleven people died and BP had to pay more than \$14 billion for the cost of the clean-up.³² The Gulf of Mexico environment was in crisis for 87 days as a result of the spill.³³

Lynn Stout states that the drive to maximise shareholder value by focusing on short-term earnings affects stakeholder goals, including long-term investors. It stops the growth of the company as there is a conflict between the rising shareholder value and the development of the company. She mentions that the solution is to build good boards instead of shareholder value thinking.³⁴ The idea of focusing only on shareholder value did not exist fifty years ago, because the company goals were not the same. The focus was not only on shareholders, but also on providing greater protection to employees and society in general.³⁵ There is no law which requires managers to increase the share price of a company. The drive to do this is purely the doing of managers themselves.³⁶

Without doubt, proper risk management is likely to decrease the occurrence of company scandals and collapse.³⁷ There are four major risk groups, and each company must identify the four categories and the links between them, knowing what is acceptable and what the company can bear. The first group is comprised of financial risks, including debt and interest rates, poor financial management, asset losses, and accounting problems. This type can be controlled by the company. The second is comprised of

³² For more detail, see the new website that BP recently set up to defend its response.

<<http://www.thestateofthegulf.com/our-view/>> accessed 10 November 2013.

³³ *ibid.*

³⁴ Lynn Stout, *The Shareholder Value Myth: How Putting Shareholders First Harms Investors, Corporations, and the Public* (Berrett Koehler Publishers 2012) 83-85.

³⁵ *ibid.* 3.

³⁶ *ibid.* 4.

³⁷ Luca Enriques and Dirk Zetsche, 'The Risky Business of Regulating Risky Management In Listed Companies' (2013) *European Company and Financial Law Review* 10 (3) 1, 2.

operational risks, including poor capacity management, employee issues (fraud, bribery and corruption), and cost overruns. This group can also be controlled by the company. The third group is comprised of strategic risks, including such external factors as pricing pressure, partner losses and industry downturns. The fourth group is comprised of hazard risks, including political issues, natural disasters, terrorism and legal issues. The last two groups cannot be controlled by the company. This analysis shows that there are financial and non-financial risks.³⁸ The question here is how to protect investors from risk management by using corporate governance. Managers can misuse their position to achieve something at the expense of the company that is not in the company's interests, such as gaining personal benefits, misbehaviour by managers, or just increasing the company's profits.

Some say that the core of the problem is caused by separating ownership and control in managing other people's money,³⁹ which is an agency theory. These problems may be avoided in the future by applying corporate governance principles. The question is how to find a proper way to enforce these principles. However, there is a danger that by introducing more regulations, economic growth will be affected. It is impossible to prevent such occurrences simply by passing laws and regulations. The quality of management must be improved to make it more ethical in an effort to stop managers engaging in and turning a blind eye to dishonest practices, with greater vigilance to stop others in the company from engaging in such practices.

5.4 No One Size Fits All

It is true that one size does not fit all listed companies in the corporate governance regime. For example, in the UK standard listed and AIM-quoted companies have more

³⁸ Alpesh Shah, 'Corporate Governance for Main Market and AIM companies' (2012) White Paper, London Stock Exchange 104.

³⁹ Alessio Paces, *Rethinking Corporate Governance: The Law and Economics of Control Powers* (Routledge 2012) 3.

flexibility about choosing what provisions they adopt than premium listed companies.⁴⁰ Moreover among premium listed companies there are differences in compliance requirements between big, small and mid-sized companies. This method of compliance will lead to development of the national stock exchange. The UK principles-based approach to corporate governance ensures the regime is valued and supports companies of all sizes because managers would do what is right for the company with ample room for firm choice that suits their own strategic and operational challenges.

The FRC and QCA Quoted Companies Alliance⁴¹ agree about the regulatory burden for small listed companies and the QCA has advised the FRC to find a way of reducing the burden areas.⁴² There are around 2000 small and medium size listed companies in the UK which represents about 85% of the listed companies in the UK.⁴³ From the number it can be said firstly that they are important to the liquidity and to the profits.

Secondly small companies with limited recourse would avoid the statutory requirements or try to withdraw from being listed on stock exchanges which would affect the growth of the economy as well as the stock exchange and the small companies.

Small companies are the engines of economic growth. Small listed companies are important to the future development in the growth of the economy⁴⁴ Complying with compulsory rules is onerous for small and middle sized listed companies.⁴⁵ It is also a

⁴⁰<<http://www.londonstockexchange.com/companies-and-advisors/aim/publications/documents/corpgov.pdf>> accessed 7 October 2015

⁴¹ QCA is independent member body that champions the interest of small and medium size listed company on London Stock exchange. One of its aims is to reduce the regulatory burden.
<<http://www.theqca.com/about-us/>> accessed 12 November 2015

⁴²<http://www.theqca.com/article_assets/articledir_210/105491/QCAResponseFRC_Improving_Quality_Reporting_Smaller_Listed_AIM_Quoted_Companies_Jul15.pdf> accessed 12 Nov. 15

⁴³ <<http://www.theqca.com/about-us/>> accessed 12 Nov. 15

⁴⁴<http://www.theqca.com/article_assets/articledir_210/105491/QCAResponseFRC_Improving_Quality_Reporting_Smaller_Listed_AIM_Quoted_Companies_Jul15.pdf> accessed 12 Nov. 15

⁴⁵ibid

big challenge for small businesses because of the costs.⁴⁶ If small companies are not encouraged to list their shares they cannot receive funding from the stock exchange which is a flexible source of capital and this process would avoid bad debts.⁴⁷

5.5 Corporate Governance in the UK

In the UK, corporate governance is regulated by a mixture of laws, rules and codes, such as the Company Act 2006, the Bribery Act 2010, the Financial Services and Market Act 2000 (FSMA), Listing Rules that apply the Corporate Governance Code, business principles, the Takeover Code, and the Stewardship Code 2010. Some of these laws, rules and codes will be mentioned in later sections because of their effect on corporate governance in the UK. However, this section will discuss the UK Corporate Governance Code.

Among the most important codes relating to corporate governance in the UK are the UK Corporate Governance Code 2010 and the UK Stewardship Code 2010, the latter of which is related to institutional investors.⁴⁸ These investors can play a role in enforcing the corporate governance code and this will be shown later. Both are published by the Financial Reporting Council (FRC).⁴⁹ In September 2012, the FRC published the new edition of the UK Corporate Governance Code. The first corporate governance code was published in 1992 (the Cadbury Code) and changes have been made to the Code since that time. The idea of ‘comply or explain’ by which a company has to comply with the code or explain why it has not, still exists, because it has flexibility (no one size fits all), and it works alongside the company law and listing rules to make the UK’s

⁴⁶ *ibid.*

⁴⁷ <<http://www.ft.com/cms/s/0/1a905c28-0aad-11e5-98d3-00144feabdc0.html#axzz3rH8e9NO7>>
accessed 12 November

⁴⁸ Institutional investors can play a significant role in corporate governance developments and enforcement, as can be seen clearly in the UK and the US, but they do not act as owners; Christine Mallin (n 6) 367.

⁴⁹ *ibid* 27.

among the highest corporate governance standards in the world.⁵⁰ After the Cadbury Code, there were a number of instruments, such as the Combined Code (1998) based on the ‘comply or explain’ idea (the company should comply with the law or explain the reason for its non-compliance). At that stage the code was purely voluntary,⁵¹ however, now it is not. This will be discussed later. This was revised in 2003, updated in 2008 and reviewed in 2009. In 2010, the Combined Code was renamed the UK Corporate Governance Code and was issued with more changes.⁵² However, there is no code that can stop company failures; codes can only reduce them.

In 2013, the FSA’s functions were taken over by the Financial Conduct Authority (FCA) and the Prudential Regulation Authority (PRA), as the result of which the FSA was renamed the FCA according to the Financial Services Act 2012, which amended the FSMA 2000. The FCA is responsible for ‘conduct of business regulation’ for all firms, while the PRA is responsible for prudential authority firms (such as banks, insurance, Lloyds of London, building societies, and some investment firms) for ‘supervision’ of prudential issues. ‘Conduct of business regulation’ means protecting investors, policing the market and promoting competition and protection for consumers.⁵³ These functions will be discussed in more detail in chapter 6. The FCA is fully funded by the companies that it regulates,⁵⁴ and it works independently of the government. The Treasury appoints the board that manages the FCA. The Finance Reporting Council (FRC) is responsible for publishing the Corporate Governance Code. The FRC is a non-profit organisation in the form of a company limited by guarantee. Funded partly by government and partly by industry, the FRC’s board is appointed by the Secretary of State for Business. The FRC is responsible for promoting high quality corporate governance, and it is an independent regulator.⁵⁵ Many of the FRC’s functions, including setting the UK

⁵⁰ Chris Hodge, ‘Corporate Governance for Main Market and AIM Companies’ (2012) White Paper London Stock Exchange 8-9.

⁵¹ <http://www.grant-thornton.co.uk/Global/Publication_pdf/Corporate_Governance_Review_2012.pdf> p6 accessed 25 June 2015

⁵² *ibid* 29-35.

⁵³ <<http://uk.practicallaw.com/7-503-5430?service=fs#a857525>> accessed 1 October 2013.

⁵⁴ <<http://www.fca.org.uk/about>> accessed 25 June 2015

⁵⁵ <<http://www.frc.org.uk/>> accessed 1 October 2013.

Corporate Governance Code, are recognised in statute under the Company Act 2006 and the Companies (Audit, Investigations and Community Enterprise) Act 2004.⁵⁶ In April 2013, both the FCA and the FRC signed a Memorandum of Understanding (MoU) for co-operation and co-ordination. This MoU sets out their different responsibilities: ‘3- The FRC is responsible for promoting high quality corporate governance and reporting to foster investment, while the FCA is responsible for the integrity of the provision of financial services to users’.⁵⁷

Listing rules can play a significant role in applying corporate governance rules. In 2011, the FSA passed new Listing Rule 9.8.6 R, which helped to apply the Corporate Governance Code. This rule⁵⁸ required that the listed company include the way that it has applied the main principles in its annual financial report. It must also show that all relevant provisions have been complied with and, if not, a statement of why the company cannot comply.⁵⁹ In the UK, application of these principles by using listing rules, which were discussed in chapter four, has produced successful results, and

⁵⁶ <<http://frc.org.uk/Our-Work/Publications/FRC-Board/Memorandum-of-Understanding-between-the-Financial.aspx>> accessed 2 October 2013

⁵⁷ *ibid.*

⁵⁸ In the case of a listed company incorporated in the United Kingdom, the following additional items must be included in its annual financial report.

(5) a statement of how the listed company has applied the ‘Main Principles’ set out in the UK Corporate Governance Code in a manner that would enable shareholders to evaluate how the principles have been applied;

(6) a statement as to whether the listed company has: (a) complied throughout the accounting period with all relevant provisions set out in the UK Corporate Governance Code or (b) not complied throughout the accounting period with all relevant provisions set out in the UK Corporate Governance Code and, if so, setting out: (i) those provisions, if any, that it has not complied with; (ii) in the case of provisions whose requirements are of a continuing nature, the period within which, if any, it did not comply with some or all of those provisions; and (iii) the company’s reasons for non-compliance...

⁵⁹ Andrew Chambers (n 11) 355.

companies are beginning to realise the importance of the application of these principles according to the FRC Report 2011.⁶⁰

As mentioned above, in the UK, there is a body (FRC) that develops corporate governance rules. Kuwait, Saudi Arabia and Qatar would benefit from having an organisation like the FRC to develop their codes.

5.6 Corporate Governance in Kuwait, Qatar and Saudi

Corporate governance in Kuwait, Qatar and Saudi is lacking in two areas. First, coverage of the various areas of corporate governance, such as risk management, is inadequate. Secondly, the methods of enforcement of the corporate governance provisions that do exist can be improved.

5.6.1 Existing Corporate Governance Provisions relating to Listed Companies

In Kuwait, Qatar and Saudi, various laws affect companies. As in the UK, some laws apply to all companies, as do the Company Act 2006 in the UK, the Companies Act 1965 in Saudi Arabia, the Companies Act 2002 in Qatar, and the Companies Act 2013 in Kuwait. Other laws apply only to listed companies and are enforced by the capital market authorities in the respective countries, such as the FCA in the UK.⁶¹

⁶⁰ Financial Reporting Council (FRC) Development (n 24) 3.

⁶¹ For example, according to Article 1 of the Kuwait Companies Act 2013, this act shall apply to companies incorporated in Kuwait or headquartered in Kuwait. Consequently, non-Kuwaiti listed companies are subject only to laws, rules and codes of the Kuwaiti Stock Exchange. If a UK company is listed on the Kuwaiti Stock Exchange, it must comply with the rules of the Kuwait Stock Exchange. The company's activities are in the UK even though it is listed on the Kuwaiti Stock Exchange. As a result, its activities must follow Kuwaiti company laws, although its listing must comply with the laws, rules and

All the above laws address issues of corporate governance either directly or indirectly. For example, the liabilities of directors and the rights of shareholders are usually contained in corporate law, while other aspects of corporate governance form part of statutory instruments, such as rules and codes, and legislation affecting listed companies. Sometimes there is an overlap between the two types of legislation namely corporate and securities legislation. When a company is listed in the same country as it is incorporated, the company will be subject to both sets of legislation. However, if a company is listed on a stock exchange in a jurisdiction other than where it is incorporated, the jurisdiction in which the stock exchange is located can hold it accountable only according to statutory instruments that apply to that stock exchange.⁶² This chapter will narrow its scope to the governance issues handled by capital market authorities, especially the codes.

5.6.2 Kuwait, Qatar and Saudi Codes

In the UK, securities regulation contains the Corporate Governance Code published by the FRC and enforced by the FCA, formerly by the FSA. The UK adopted a principles-based approach to corporate governance rather than a rules-based approach. Sometimes there is an overlap with other rules, such as disclosure rules, or the principles needed to add separate rules, such as risk management, which will be discussed later. This means that companies whose shares are listed on the main markets of the London Stock Exchange Limited do not have to comply with the Code. However, if they decide not to

code of the London Stock Exchange. Consequently, the Kuwaiti company does not have to comply with the UK Company Act 2006.

⁶² In Saudi Arabia, there are different laws, rules and codes, such as Shari'ah Law, the Companies Law 1965, the Capital Market Law 2003, listing rules, and the corporate governance regulations (the Code) 2006 that deal with corporate governance areas; Gonzalo Puig and Bader Al-haddab, 'The Protection of the Minority Shareholders in the Gulf Cooperation Council' (2013) 13(1) JCLS (123-149) 3.

Qatar has the Commercial Companies Law 2002, Law No. (8), the Qatar Financial Markets Authority 2012 listing and the Qatari Corporate Governance Code 2009 that deal with corporate governance areas.

Kuwait has the Companies Law 2013, the Securities Law 2010 and listing rules, disclosure rules and the Corporate Governance Regulations 2013 (the Code) that deal with corporate governance areas.

comply, they must explain to their shareholders the reasons for non-compliance. Furthermore, they must include in their annual report and accounts two statements: (1) an explanation about how the company has applied the main and supporting principles; and (2) a statement about whether the company has complied with the provisions throughout the year covered by the report. If the company has not complied with all provisions or has complied with them for only part of the year, the company must state its reasons for non-compliance. See Appendix 2 for an example of such a statement.

The ‘comply or explain’ approach is a key feature of the UK 2012 Code. However, the GCC countries have different approaches to corporate governance and its enforcement. In Kuwait, compliance is mandatory, and failure to comply is a breach of Securities Law No 7 of 2010. Moreover, a company must send a quarterly report to the Kuwaiti Capital Market Authority confirming that it has complied with all of the corporate governance provisions. Qatar has adopted a ‘comply or explain’ approach, but the explanation must be provided to the Qatari Financial Market Authority (QFMA), not the shareholders, in the form of an annual report. Nevertheless, the filing enables the company’s shareholders and the public to assess the company’s commitment to the principles of corporate governance.⁶³ In 2006, the Saudi Corporate Governance Code was introduced based on the ‘comply or explain’ approach. However, over time, certain of the original provisions have become mandatory. For instance, in 2008, 2010, 2011 and 2012, Articles 8, 15, 10 and 5 respectively were changed to compulsory rules. It would have been better if mandatory and voluntary provisions had not been mixed in the same code. Explanation for non-compliance with the voluntary provisions must be made to the shareholders, although the company must include a corporate governance statement in its annual board report.⁶⁴

Although the codes of Kuwait, Qatar and Saudi have principles, supporting principles and provisions, they are not the same in each country.

⁶³ Qatari Code 2009, Article 2.

⁶⁴ Saudi Code 2009, Article 1 part C, Article 9 part A.

5.6.2.1 Corporate Governance Principles in Kuwait, Qatar and Saudi

No common corporate governance principles are enforced in all of the states. These principles differ from country to country. For example, the principles of corporate governance mentioned in the Qatar Rules 2009 are intended to protect the interests of minority shareholders and to govern the responsibilities of the board of directors, accounting and auditing, transparency of ownership and control, and the regulatory environment. However, in Kuwait, the Corporate Governance Code is extensive. Resolution No 25 of 2013 includes eleven principles that strengthen board composition, establish clear roles and responsibilities, recruit highly qualified candidates for boards of directors and senior management, safeguard integrity in financial reporting, require sound systems of risk management and internal controls, promote ethical standards and responsible conduct, ensure timely and high quality disclosure, recognise the legitimate interests of stakeholders, encourage enhanced performance, stress the importance of social responsibility⁶⁵ and finally protect the rights of shareholders.⁶⁶

However, the Saudi 2006 Corporate Governance Code has fewer principles than Kuwait and Qatar. It focuses on three areas according to Governance Code 2006. Part 2 of the Code mentions rights of shareholders and the general assembly, part 3 requires disclosure and transparency, and, finally, part 4 provides board of director principles.

Under each of the main principles are supporting principles. For instance, in the UK, under the first main ‘leadership principle’, there are four supporting principles, namely

⁶⁵ That could happen, for example, when the company is working to achieve a balance between the objectives of the company and the community in the context of assistance in providing job opportunities, supporting small projects, protecting the environment from pollution, contributing to the reduction of the negative phenomena in society, etc. according to Kuwaiti Corporate Governance Code 2013.

⁶⁶ An example of such protection is not to have shareholder funds expropriated by the managers of a company.

the role of the board, division of responsibilities, the chairman and finally non-executive directors.

5.6.2.2 Corporate Governance Sub-Principles in Kuwait, Qatar and Saudi

There are differences in the sub-principles among the GCC countries, such as those relating to board committees. One of the most important supporting principles under corporate governance codes is to form committees.⁶⁷

Kuwait requires the formation of five committees, while Qatar requires only three and Saudi Arabia requires two. According to Kuwaiti Corporate Governance Code 2013, each board must form five different types of committee:

- (1) Audit Committee: According to principle 4/2, the board of directors must form a committee concerned with internal audit. Its primary role is to ensure the integrity of the financial reporting and internal control systems and to

⁶⁷ Examples of committees:

A. Audit Committee

In modern business, internal audit plays a significant role in corporate governance, because the management does not have sufficient knowledge and time it delegates some tasks to an internal auditor. This is simply an internal job, which is part of the management's tasks. The audit committee, acting on behalf of the board, monitors the quality of both external and internal audits; Andrew Chambers (n 9) 380-38.

One problem that could be solved by the audit committee is to require the committee to report the way they are selected by the external auditor; Financial Reporting Council (n 24) 19.

B. Remuneration Committee

More transparency is required in the remuneration committee report in terms of the remuneration plan, company policy, the risk and the link among these things; *ibid* 19.

c. Nominations committee

Nomination is an important point, because a person could be loyal to the person who appointed him, so that he could give that person information from the board.

recommend the nomination of the external auditor to the board. Thereafter, the general assembly appoints the external auditor in accordance with the nomination of the board of directors.

(2) Risk Management Committee: The company must form a committee concerned with risk management according to principle 5/2.

(3) Governance Committee: The board of directors must form a committee concerned with the application of governance according to principle 5/4.

(4) Nomination Committee: According to principle 3/1, the board of directors must form a committee concerned with nominations for appointment. Its primary role is to prepare recommendations on all proposed nominations to achieve the perfect selection of competent people with professional expertise and technical capacity for the board of directors and senior management.

(5) Remuneration Committee: According to principle 3/2, the board of directors must form a committee concerned with bonuses, its primary role being the development of policies and regulations for granting compensation and bonuses.

It should be noted that, in Kuwait, the formation of committees is the responsibility of the board of directors and is not limited to the above committees. The board of directors can form any other committees that it deems necessary for the company in accordance with principle 2/2 of the Kuwaiti Corporate Governance Code 2013, which states that the board of directors must form specialised and independent committees to help the board achieve its tasks.

According to Article 5 of the Qatar Corporate Code 2009, the board is allowed to delegate some of its powers and to form special committees to do specific operations, although the board remains responsible for all of the powers and authority that it delegates. The board shall form three committees, which are the Nominations Committee, the Remuneration Committee and the Audit Committee, as provided in Articles 15, 16 and 17 respectively.

In Saudi Arabia, the board determines the suitable number of committees that are needed, although two committees are required. In 2008, an audit committee was required, and, in 2010, a nomination and remuneration committee was required. Kuwait and Qatar separate the nomination and remuneration committees, while Saudi Arabia puts both in one committee.

5.6.2.3 Corporate Governance Provisions in Kuwait, Qatar and Saudi

The corporate governance codes in Kuwait, Qatar and Saudi not only differ at the principle and sub-principle levels, but they also differ in terms of the provisions that make up the principles and sub-principles. The differing provisions relating to board composition will be highlighted below.

One of the corporate governance principles is to strengthen board composition, which contains a number of points, including diversity (directors with different experience and attributes and even gender), independence (including independent and non-executive directors), and board election.⁶⁸ To achieve this goal, a number of provisions must be followed, including, for example, ensuring that directors are independent.⁶⁹

In Kuwait, provision 1.1.C of the 2013 Code provides that the majority of the members of the board of directors must be non-executive members and that the board must include independent members, although the number of independent directors cannot exceed half the number of board members. In Qatar, Article 9, provision 2, states that a

⁶⁸ In Kuwait, one of the principles that is taken into account when forming the board of directors is diversity in experience, professional and competent skills, and members also have to know the laws, regulations, and the rights and duties of the board of directors, according to Rule One of the Kuwaiti Corporate Governance Code 2013.

⁶⁹ An independent member is a member who is not under the influence of anything that limits his ability to make decisions objectively and impartially, based on the facts only. For example, an independent member does not work in the company and is not a relative of one of the members of the senior management executive, according to article 1 of the Qatari Corporate Governance System 2009.

third of the directors must be independent directors. In Saudi Arabia, Article 12, provision (e), states that the board includes two independent directors or one-third of the board, whichever is greater.

In the UK, provision B.1.2 distinguishes between the FTSE 350 companies, which are large companies, and small companies. The board of the latter is required to contain at least two independent non-executive directors, while at least half of the former board must be comprised of independent directors.

Another example of differences among Kuwait, Qatar and Saudi concerns the re-election of directors. Kuwait provision 1.1.b and Saudi Article 12, provision 2, provide for the same re-election period not to exceed three election years and that a director may be re-elected unless the Articles of Association provide otherwise. In the UK, an annual re-election is required according to provision B.7.1 of the 2012 code.

The third example concerns the number of directors. In Saudi Arabia, Article 12, entitled 'Formation of the Board', has nine provisions. For example, a provision mentions that the number of directors shall not be fewer than three and not more than eleven, as specified in the Articles of Association. In Kuwait, there must be at least five directors according to provision 1.1.A of the Kuwait code. The codes in Qatar and the UK do not specify a required number of directors.

Sometimes agreement is reached about a provision, such as the ban against combining the positions of chairman of the board and chief executive officer imposed in Qatari Code Article 7, Kuwaiti provision 1.1.D, Saudi Article 12 provision d, and UK provision A.2.1.⁷⁰

⁷⁰ Qatar Corporate Governance Code 2009 mentions the traditional relationship between the board and executives by saying that it is assumed that the executives shall prepare plans for the functioning of the company and propose these plans to the board of directors for review, audit and application, which have

The country	Main principle	Supporting principle	Articles	Provision
UK	5	18	-----	53
Kuwait	11	32	-----	More than 235
Qatar	5	-----	31	Around 85
Saudi Arabia	3	-----	19	Around 63

Table 5.1 Comparison of the Corporate Governance Codes

Corporate governance code requirements do not distinguish between companies of different sizes. What is appropriate for a large company may not be appropriate for a smaller company, which may find it too costly to comply. One size does not fit all. In the UK, under the ‘comply or explain’ regime, such a company need not comply. However, where compliance is mandatory, all of the companies are the same.

Under these circumstances, it seems that Kuwait needs two important things. The first is the creation of various bodies, as exist in the UK, to find a proper way to develop and enforce corporate governance principles. The second is deciding the balance between mandatory rules consisting of statutory requirements, such as securities laws and rules, and regulations backed by statute on one hand and principles that operate on a ‘comply or explain’ basis on the other hand.

5.7 Enforcement of Corporate Governance

Companies fail because they are poorly managed by the board of directors or because of external risks and factors (the economy, interest rates, exchange rates etc). Accordingly,

been approved. Thereafter, the board of directors pursue the application of these plans and ask the executives for performance results.

the law aims to encourage good management by the board. Good corporate governance is a modern subject, and the optimal application of corporate governance helps to reduce these failures. The question here is how to avoid such failures to protect the investors in the long or the short term.

The traditional ways of enforcing corporate governance principles are not suitable for the real world today. The world needs a new framework for the enforcement of corporate governance principles. Through rules and codes, the securities laws can help to form this framework. There is a diversity of enforcement methods. Different aspects of corporate governance are enforced in different ways. Some are enforced by corporate law,⁷¹ while others are dealt with by securities laws⁷² and delegated legislation in the forms of rules⁷³ and voluntary⁷⁴ and mandatory codes.⁷⁵

Although a takeover bid is part of securities regulations in Kuwait, and it is an important principle related to corporate governance, it is beyond the scope of this study. This section will look at an example of mandatory rules related to risk management and at the voluntary corporate governance code. Lawmakers have different ideas about how to enforce corporate governance principles. Some prefer to enforce these principles by law, while others prefer to enforce them via a ‘comply or explain’ regime.⁷⁶

⁷¹ Kuwait Companies Law 2013; UK Company Act 2006.

⁷² UK FSMA 2000; Kuwaiti Law No. 7 of 2010.

⁷³ Listing Rules; Disclosure Rules; FCA’s principles for business (the principles).

⁷⁴ UK Corporate Governance Code 2012.

⁷⁵ Kuwait Corporate Governance Code 2013.

⁷⁶ Applying corporate governance by law has the potential to cause two problems. The first is that it can harm the growth of the economy. The other problem with applying corporate governance principles by law can occur if the company faces financial and administrative burdens as a result of applying all corporate governance principles and consequently needs to employ more staff, spend more money, or gain more legal knowledge about the way to apply these rules and how to bear the cost. Despite this, some countries in Europe have replaced the ‘comply or explain’ regime with law, because they believe that the board and managers are part of the problem, not part of the solution.

In Kuwait, according to the Corporate Governance Rules 2013, a company must comply and does not have the option of not complying by explaining why it has not complied. Voluntary compliance has advantages for businesses. The nature of business requires a flexible and easily developed means of enforcement, because one size does not fit all. Although the UK is one of the developed countries in the field of corporate governance, corporate governance principles could be enforced by law. However, the British oppose this idea. This can be clearly seen from the FRC opinion that applying the 2012 code by law would have some side effects on economic growth.⁷⁷ It would be better if Kuwait, Qatar and Saudi followed the example of the UK in terms of applying all of the principles.

Kuwait, Qatar and Saudi issued securities regulations on corporate governance in 2010, 2012 and 2007 respectively. However, Kuwait, Qatar and Saudi securities regulations do not cover some of the corporate governance aspects, such as risk management, and there is no voluntary code which is different from mandatory rules as in the UK.

Board responsibility extends to risk management in many countries. For example, in 2010, the UK extended the board's responsibility for risk to include the nature and the extent of its strategy by deciding the risk facing the business, in addition to the responsibility for the risk of management and control systems according to the Corporate Governance Code.⁷⁸ Risk management is not confined to corporate governance code. It is also part of the mandatory principles of business. However, the later do not apply to all issuers. They only apply to certain firms defined as firms "Authorised" by the FCA to offer certain financial products and services including consumer credit firms, banks, investment managers and brokers, insurer and financial advisers. For example, on 9 September 2013, Morgan Chase Bank NA (JP Morgan) was fined £137,610,000 for serious failings related to its Chief Investment Officer (CIO) as a result of high risk taking and weak management causing a £6.2 billion trading loss in

⁷⁷ Financial Reporting Council (n 24) 2.

⁷⁸ <http://www.charteredaccountants.ie/en/Members/Technical/Corporate-Governance/Corporate-Governance-Articles/Risk-Management-and-the-new-UK-Corporate-Governance-Code---Bevan-Lloyd-FCA/> accessed 30 November 2013.

2012.⁷⁹ The FCA believed that poor risk management harmed the integrity of the market, as demonstrated by the statement of the FCA's director of enforcement and financial crime, Tracey McDermott,⁸⁰ which described this incident as a lesson for all companies.⁸¹ Therefore, this diversity of enforcement (one size does not fit all) depends on the importance of a principle and its impact.

The Corporate Governance Rules 2013 in Kuwait also increased the responsibility of the board of directors by including sound systems for risk management and internal control. This means that the board of directors has the ability to understand and analyse the nature and level of risks to enable the company to reduce them as much as possible. The company is required to provide a number of principles, including creating a department or unit or an independent office of risk management to identify and measure the risks to the company according to Principle 5/1 of the Kuwaiti Corporate Governance Code 2013. The company must also form a committee concerned with risk management according to Principle 5/2 of the Kuwaiti Corporate Governance Code 2013. Saudi Article 10, part (b) 3 of the Code 2006 provides that one of the main functions of the board of directors is to control and forecast the risk management and to disclose risks with transparency. Comparing Kuwaiti and Saudi codes reveals that the Kuwaiti Code 2013 provides the way to manage the risk by forming a committee and creating a department dedicated to risk management, while the Saudi code leaves to the board of directors the freedom to fulfil its obligations to risk management. Under the 'comply or explain' system, compliance is voluntary. A company cannot face sanctions for non-compliance, only for not explaining its non-compliance. For example, some contend that the UK Corporate Governance Code lacks teeth. Moreover, the UK code

⁷⁹ <<https://www.fca.org.uk/news/jpmorgan-chase-bank-na-fined>> accessed 25 June 2015

⁸⁰ She stated:

When the scale of the problems at JP Morgan became apparent, it sent a shock-wave through the markets. Maintaining the integrity of markets is a key part of our wholesale conduct agenda. We consider JP Morgan's failings to be extremely serious such as to undermine the trust and confidence in UK financial markets.

⁸¹ <<https://www.fca.org.uk/news/jpmorgan-chase-bank-na-fined>> accessed 25 June 2015

allows the company's board a wide discretion for compliance. This idea will be discussed in more detail in the next chapter.

In Article 1 of its 2006 Code, the Saudi legislature clarifies mandatory application by separating principles into optional and mandatory principles and using the 'comply or explain' regime. During the period between 5 October and 7 November 2013, four companies were fined for breaching Article 9, which is entitled 'Disclosure in the Board of Directors' Report', because their board reports did not include the 'comply or explain' system of corporate governance principles.⁸² The Saudi code requires disclosure to the shareholders in the boards' reports, as does UK law, while Qatar Article 30 of the 2009 code requires disclosure once a year, and Kuwait requires disclosure four times a year to the Authority.

The Qatari legislature has also adopted the 'comply or explain' regime. Article 2 of the Qatari Corporate Governance Rules 2009 mentions 'the principle of comply or explain non-compliance', which means that the company should disclose the extent of its compliance with the provisions of corporate governance; otherwise, in the case of non-compliance, the company has to determine the material that did not comply and explain the reasons therefore.

In Kuwait, in accordance with part four of Decision No 25 of 2013, the listed companies must provide the Kuwaiti Authority with a report on a quarterly basis about the implementation of these rules, and, if they fail to comply with the rules, the Authority can hold an offender accountable according to Law 7 of 2007. After passing the new rules about corporate governance in 2013, some people in Kuwait revealed the occurrence of intensive contact between listed companies at the highest levels to prepare for a meeting to lobby against this decision, because everyone was convinced about the impossibility of practical application.⁸³ The Kuwaiti 2013 code runs to 70 pages, is very detailed and places a heavy compliance burden on companies.

⁸² <<http://www.cma.org.sa/ar/News/Pages/default.aspx>> accessed 11 October 2013.

⁸³ <<http://alwatan.kuwait.tt/ArticleDetails.aspx?Id=296959>> accessed 12 August 2013.

Part of the enforcement of the corporate governance code can be accomplished through listing rules. For example, the British legislature uses listing rules to apply these principles. Therefore, in the UK, if a company does not mention why it did not comply with the rules of governance in its report, it is in violation of the listing rules.⁸⁴ The British use this style because the UK Corporate Governance Code is arranged by the Financial Reporting Council (FRC), although the FRC has no power to enforce corporate governance.⁸⁵ As a result, some say that one of the real problems with applying corporate governance is how to close the gap between actual implementation and the formal provisions.⁸⁶ Diversity in enforcement, including rules and codes, could help.

The best solution for Kuwait to prevent the corporate failures that have afflicted large companies all over the world in terms of securities regulation is, firstly, by creating a new body. Its task should be to develop a corporate governance code over time, such as the FRC in the UK,⁸⁷ because corporate governance needs to develop and be reviewed over time.⁸⁸ Secondly, Kuwait can use a mix of mandatory and voluntary enforcement mechanisms.

⁸⁴ Financial Reporting Council (n 24) 15.

⁸⁵ Andrew Chambers (n 11) 455.

⁸⁶ Fianna Joesover and Grant Kirkpatrick (n 27) 11-12.

⁸⁷ The Corporate Governance Code in the UK is updated every two years. < <http://www.frc.org.uk/Our-Work/Codes-Standards/Corporate-governance.aspx>> accessed 31 October 2013

⁸⁸ The head of the primary markets on the London Stock Exchange, Alastair Walmsley, emphasised that saying that ‘we firmly believe that high standards of corporate governance make an important contribution to companies’ long term performance. By regularly reviewing and developing appropriate corporate governance practices whatever the prevailing macro-economic conditions’; Alastair Walmsley, ‘Corporate Governance for Main Market and AIM Companies’ (2012) White Paper, London Stock Exchange 3.

5.8 Conclusion

This chapter has addressed the third aspect of protection of individual investors in shares in quoted companies, namely corporate governance codes that apply to companies whose shares are listed on a stock exchange. This chapter has focused specifically on these securities laws and regulations as they affect investors in listed companies. This chapter has not attempted to discuss the various theories, such as the agency theory, because the chapter focuses on the real world, which is not adequately explained by any of the theories. In reality, some actions of managers harm investors and other stakeholders, including local communities.

This chapter has compared the provisions of corporate governance in the UK and those in Saudi Qatar and Kuwait, where, unlike the UK, there is a mixture of mandatory and voluntary rules. By comparing the UK, Saudi and Qatar codes with the Kuwaiti code, some important differences have been found. While the UK uses a principles-based approach, Kuwait uses mandatory rules. The question here is whether voluntary rules would work properly in Kuwait. That will be discussed in the next chapter to determine which rules are better, voluntary or mandatory.

Although the Kuwaiti code could be made voluntary, much work would still be required to explain non-compliance rules. Consequently, one needs to look at how the number of provisions can be reduced. The UK, for example, has 53 provisions, as compared to Kuwait, which has more than 235 provisions. The size of the code is another problem. Some provisions that are in company law are also needed in the code, because an overseas listed company would not be subject to Kuwaiti company law. Kuwait might need a different code for national and international companies. In addition, the Kuwaiti code should distinguish between large and small companies in some provisions, as is done in the UK. Changing the code will take time. However, the financial culture also needs to be changed, which cannot be achieved without having a sound regulatory authority, as will be discussed in the next chapter.

Chapter Six

Sound Regulatory Authority

6.1 Introduction

The previous three chapters discussed the problems encountered in protecting investors. However, this chapter will focus on a sound regulatory authority as a solution. Most countries have a regulatory authority¹ to regulate their capital market. In the UK it is called the Financial Conduct Authority (FCA); in the GCC countries it is called the Capital Market Authority. In this chapter, the words ‘regulatory authority’ mean any regulatory capital market authority. A regulatory authority can be defined as an administrative body created by a special law or secondary legislation to supervise industrial, financial, or commercial activities. It has financial independence and does not rely on the state for funds.²

Robert Shiller likens a regulatory authority to a referee in sporting events, because both the referee and the regulatory authority can enforce rules by deciding when the rules are broken and when people should be punished. Everyone agrees about the importance of the referee in sporting events. Players sometimes argue with the referee, but they need him, because without him it would not be a good game. For example, dangerous players could hurt other players. Whilst sometimes taking risks is the key to winning the game, the referee will stop players from taking dangerous risks. Shiller emphasises that people in sports and business ask for regulations. This is the idea of this chapter, namely how

¹ In the UK, the regulations use the term ‘regulatory’ (Financial Services Act 2012) instead of the term ‘authority’.

² Zaid Aboa, *Management of Public Institutions: Foundations of the application of administrative functions* (Dar Al Shorouk 2009) 19.

to build a regulatory authority that will serve as an effective referee in the business world.³

Establishing a regulatory authority can help to eliminate red tape ,or excessive bureaucracy, in the public sector, provide better regulation and enforcement, ease the introduction of modern methods in management and administration, provide stability, and ensure the appropriate climate is free from political exploitation.⁴ The term ‘red tape’ has been used since the sixteenth century to describe the negative effects of bad or excessive rules, regulations and procedures, many of which are ongoing and adversely affect the performance of public organisations.⁵ Such a regulatory authority needs to be effective and efficient to protect investors. Effectiveness differs from efficiency. Effectiveness is about achieving the authority’s goals; efficiency is about the good use of resources.⁶ Resources include human, financial, and material resources, as well as information and ideas. Therefore, a good regulatory authority can achieve its objectives in an efficient way.

For a regulatory authority to protect investors effectively, it needs to: (1) have independence; (2) introduce sound regulation; and (3) create strong investors.

6.2 Sound Independent Regulatory Authority

Securities authorities in Kuwait, Qatar and Saudi were established only recently. To assess their adequacy, it is helpful to compare them with a system like the one in the UK, which has existed for much longer, but which has undergone a number of change.

³ Robert Shiller, ‘Behavioral Finance and the Role of Psychology’ (2011) Lecture, Open Yale University Courses I Tunes.

⁴ Zaid Aboa (n 2) 20.

⁵ Gene Brewer, Richard Walker, ‘Red Tape: The Bane of Public Organisations?’ in Richard Walker, George Boye and Gene Brewer (eds) *Public Management and Performance: Research Directions* (Cambridge University Press 2010) 110-111.

⁶ Zaid Aboa (n 2) 36.

6.2.1 Regulatory Authority in the UK

The development of the regulatory authorities in the UK has passed through four important phases.

6.2.1.1 No-Statutes Era

Before the 1980s, the regulation of the financial services industry was limited largely to self-regulation, because the Investment Act 1958 was limited as a regulatory tool. It covered only a small part of the financial services market.⁷ Therefore, regulation was ad hoc and attempted by largely unenforced industry codes of practice.⁸

6.2.1.2 Period between 1986 and 2001

In 1986, the original Financial Services Act was enacted, which created the Securities and Investment Board (SIB).⁹ The SIB was the first self-regulatory organisation under a statutory framework, which gave it the power to oversee other organisations that regulated themselves, called self-regulating organisations (SROs). One such SRO was the Securities and Futures Authority, which regulated stock exchanges. Therefore, a mixture of the state and SROs specified, administered and enforced the regulations, with the SIB acting as an umbrella to oversee a number of SROs, such as the Securities and Futures Authority.

⁷ Financial Markets and Services Bill, 6.

<http://www.parliament.uk/documents/commons/lib/research/rp99/rp99-068.pdf> accessed 13 January 2014.

⁸ Steve Bloor, 'After 25 Years of Regulation are consumers better protected?' (2013)

<http://www.ifaonline.co.uk/ifaonline/opinion/2258975/after-25-years-of-regulation-are-consumers-better-protected> accessed 14 January 2014.

⁹ Its structure is a company limited by guarantee, which was incorporated in 1985.

Accordingly, a number of organisations were responsible for the financial services industry in the UK, including the SIB and several SROs, which resulted in less efficient and effective regulation.¹⁰ As a result of the lack of rapid response to problems and the occurrence of costly overlaps, a number of scandals occurred, such as mis-selling pensions.¹¹ In 1995, Barings Bank which had been established in 1762, collapsed causing losses of approximately £827 million. The losses were caused by the trading of one bank employee who was working in the bank's office in Singapore.

It was thought that creating a single regulatory body would avoid such problems in the future. Consequently, the Financial Services Authority (FSA) replaced the SIB in 1997. The FSA combined nine separate agencies¹² to regulate the whole financial services industry in the UK.¹³ The FSA was a company limited by guarantee.¹⁴ The Financial Services and Market Act 2000 (FSMA) gave the FSA its objectives and its powers. The new statutory system provided more protection to investors. The FSA was given more enforcement power and was authorised to impose strong fines.¹⁵

6.2.1.3 Period between 2001 and 2012

On 30 December 2001, Chancellor of the Exchequer Gordon Brown agreed to the independence of the FSA from the government, although it had to be properly

¹⁰ Moreover, prudential regulation was given to the FSA. The banking supervision functions were transferred from the Bank of England to the FSA by the Bank of England Act 1998; Dalvinder Singh, *Banking Regulation of the UK and the US Financial Markets* (Ashgate 2007) 15.

¹¹ Steve Bloor (n 8).

¹² 1- Building Societies Commission; 2- Friendly Societies Commission; 3- Insurance Directorate; 4- Registry of Friendly Societies; 5- Bank of England's Supervision and Surveillance Division; 6- Investment Management Regulatory Organisation; 7- Personal Investment Authority; 8- Securities and Future Authority; 9- Securities and Investment Board.

¹³ <<http://www.publications.parliament.uk/pa/ld200809/ldselect/ldeconaf/101/10108.htm>> accessed 11 January 2014.

¹⁴ Company NO 1920623.

¹⁵ Financial Markets and Services Bill (n 7) 21.

accountable to the government, Parliament and to other stakeholders. He emphasised the advantage of having such an independent body for business and for consumers, according to a letter sent to Sir Howard Davies, the Chairman of the FSA.¹⁶

To sum up, in 2001, self-regulatory organisations (SROs) were replaced by a single statutory regulatory authority called the FSA. The FSA's responsibility was for regulating banks and providers of financial services. Theoretically, it had two roles. One was the prudential regulation of all of the above institutions; the other was the regulation of how they conducted their business. The FSA was an independent body and was accountable to Parliament. However, the FSA was not part of the Bank of England which was solely responsible for making financial policy, and the Treasury was responsible for passing the necessary statutory instruments to empower the FSA. The financial crisis of 2007-2008 highlighted some failings in these arrangements. The FSA had focused on the conduct of business at the expense of prudential regulation. This prompted the government to introduce a different structure for the regulation of financial activities in 2012.

The regulatory model in the UK has evolved over many years. The diagram below (Figure 6.1) shows the milestones in the development of the regulatory authority system in the UK.

¹⁶ <http://webarchive.nationalarchives.gov.uk/+http://www.hm-treasury.gov.uk/newsroom_and_speeches/press/2001/press_144_01.cfm> accessed 11 January 2014.

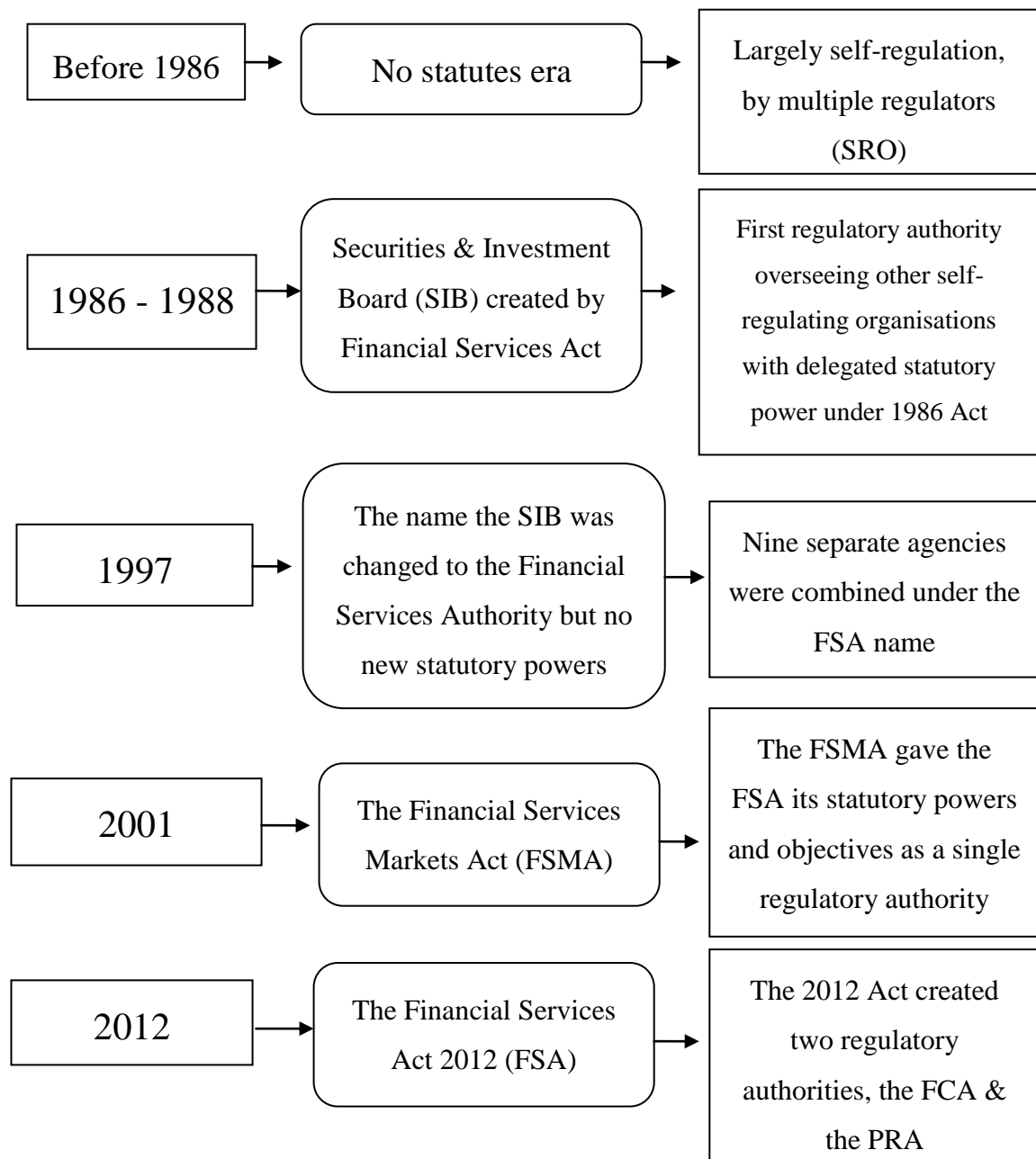


Figure 6.1 Milestones in the Development of Regulatory Authority System in the UK.

6.2.1.4 Period After 2012

Under the new structure, the responsibility of the Bank of England¹⁷ would no longer be limited to financial policy, but would also include the micro-prudential regulation of

¹⁷ In addition, the Banking Act 2009 gave the Bank of England the responsibility for financial stability, which would not work effectively without allocating to it the responsibility for micro-prudential

insurers, deposit takers and major investment firms through the creation of a Prudential Regulation Authority (PRA)¹⁸ to promote their safety and soundness and minimise adverse effects on the stability of the financial system. In addition, the macro-prudential regulation of the financial systems as a whole would be undertaken by the newly created Financial Policy Committee (FPC). The PRA is now a subsidiary of the Bank of England, unlike the FSA.

The Financial Services Act 2012 created two regulators, the FCA and the PRA.¹⁹ Although the FCA is not part of the Bank of England, the PRA is, and it is responsible for the supervision and the prudential regulation of banks, major investment firms, building societies, credit unions and insurers, promoting safety and soundness to those firms and protecting policyholders.²⁰ The chair of the PRA is the Governor of the Bank of England, and the chief executive is the Deputy Governor for Prudential Regulation.²¹

The Financial Conduct Authority (FCA) has been created as a separate institution from the Bank of England to regulate the conduct of financial services firms. The FCA's duties include preventing market abuse and ensuring that financial firms treat their customers fairly. Its three major objectives are 1) protecting consumers; 2) promoting the integrity of the financial system; and 3) promoting effective competition. It is also responsible for the micro-prudential regulation of those financial services that are not supervised by the PRA, such as, for example, asset managers, hedge funds, many brokers, dealers, independent financial advisers, and listed companies. See Figure 6.2.

supervision. Its augmented responsibilities and corresponding authority clearly put the Bank of England in charge. See Figure 6.1.

¹⁸ Emma Murphy and Stephen Senior, 'The Changes to the Bank of England', <<http://www.bankofengland.co.uk/publications/Documents/quarterlybulletin/2013/qb130102.pdf>> accessed 16 January 2014.

¹⁹ Financial Services Act 2012 sch 3A part 2.

²⁰ <<http://www.bankofengland.co.uk/pru/pages/default.aspx>> accessed 11 January 2014.

²¹ Financial Services Act 2012 Schedule 1ZB s2.

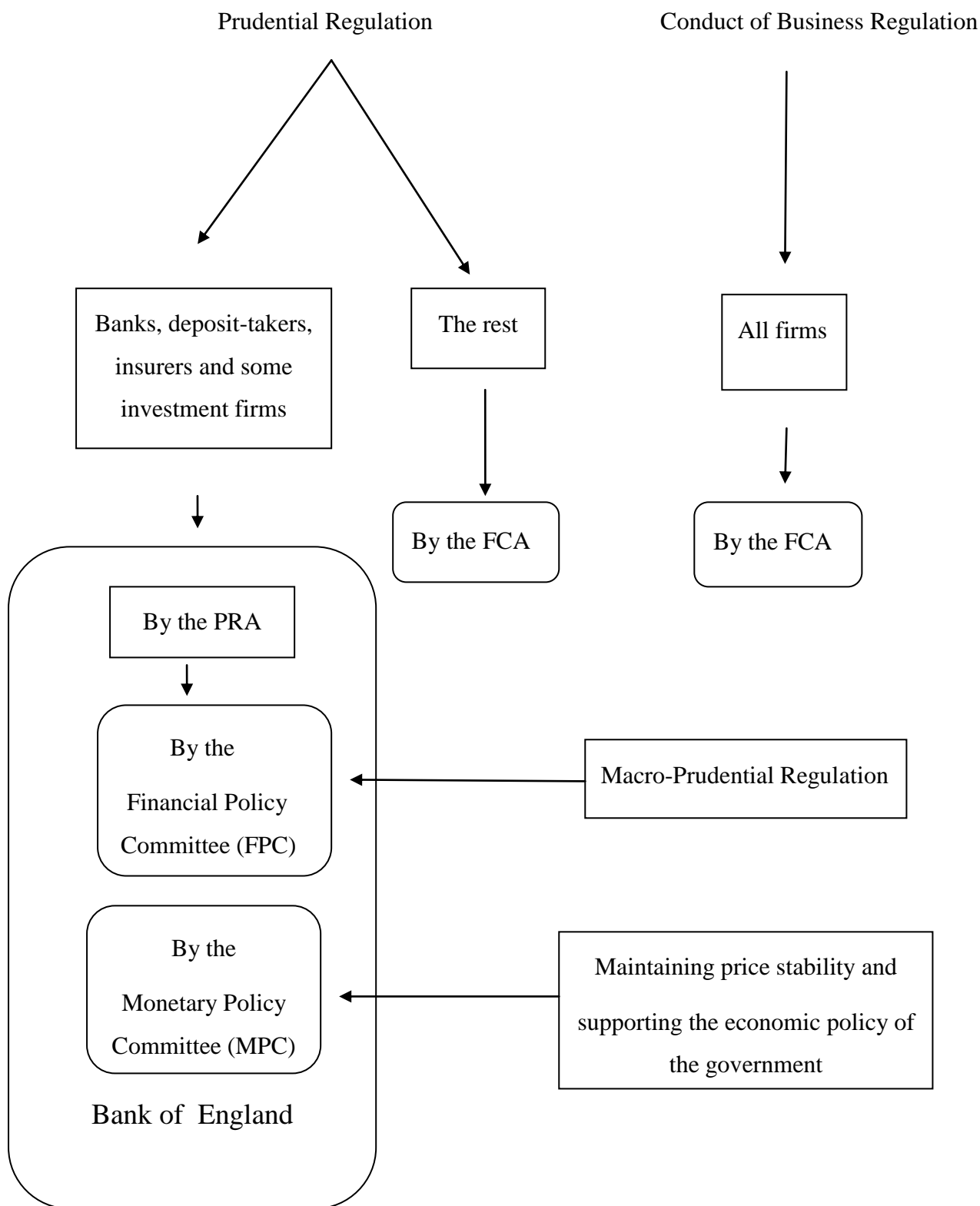


Figure 6.2 Regulatory System in the UK

Figure 6.2 shows the regulatory responsibility of the Financial Policy Committee (FPC), the Prudential Regulation Authority (PRA) and the Financial Conduct Authority (FCA).

Bloor argues that the latest regulatory arrangements are not dissimilar to those of 1988, which were subsequently changed in 2001, saying, ‘if it did not work before what are its chances this time?’²² Arguably, in this case no one can guarantee that this new arrangement will be more effective – it has to be tried and tested.

6.2.2 Regulatory Authority in Kuwait, Qatar and Saudi

Kuwait, Qatar and Saudi describe their regulatory authorities as independent bodies. In Kuwait, the law states that the authority is an independent body having a legal personality and that it is overseen by a Minister of Trade and Industry.²³ In Saudi Arabia, the law mentions that the authority has financial and administrative autonomy and must report to the President of the Council of Ministers and that it has a legal personality.²⁴ In Qatar, according to Article 4 of Qatari Law 2012, the Authority has financial and administrative independence and a legal personality. The Authority must report to the Governor of Qatar’s Central Bank.²⁵

Although the term ‘independence’ is used, careful analysis of the text hereunder will show the extent to which this is true. To that end, the soundness and independence of the regulatory authorities in Kuwait, Qatar and Saudi will be assessed in terms of their composition, funding arrangements, accountability and freedom of action from political and commercial interference.

6.2.2.1 Composition

The following section discusses the members of the board of the Authority.

²² Steve Bloor (n 8).

²³ Capital Market Law 2010, Article 2.

²⁴ Capital Market Law 2003, Article 4.

²⁵ Qatar Financial Market Authority Law No 8 of 2012, Article 3.

The regulatory authority is administered by a board called the Board of Commissioners. In Kuwait, the board consists of five full-time members. An Emiri Decree is issued to appoint them, and it specifies the chairman and the deputy chairman.²⁶ Article 12 mentions that the Emiri Decree determines the board's salaries and benefits. In Saudi, the board of the Capital Market Authority (five members) is appointed by Royal Order. It determines their salaries and financial benefits and specifies the chairman and the deputy chairman.²⁷

The Qatari legislation is unlike Saudi and Kuwaiti legislation regarding the appointment of the board. Although Qatari Law 2012 mentions in Article 6 that the appointment of the board has to be determined by Emir Decree, the majority of the board's seven members are known in advance, so that the Emiri Decree has no real impact. Article 6 states that the chairman of the board and the deputy chairman are the Governor and the Deputy Governor of the Qatar Central Bank. The Governor selects two experienced people. Two further members represent the Ministry of Economy and Finance and the Ministry of Business and Trade, respectively. The last of the seven members is the chief executive officer of the Qatar Financial Centre Regulatory Authority (QFCRA).

Clearly, the Qatar legislation has realised the effects of shadow bank institutions (non-bank financial intermediaries that provide services similar to traditional banks) on the financial systems as a whole, thus giving the central bank more power by appointing the governor and the deputy governor of the central bank as the chairman and deputy chairman of the board of the authority, which could affect the conduct of business. It would be better if the GCC countries had separate bodies, such as the FCA and the PRA in the UK for the reasons explained earlier in this thesis.

Qatari legislation is also unlike Saudi and Kuwaiti legislation in that the members of the authority board are not full-time. They perform their duties in addition to their main

²⁶ Capital Market Law 2010, Article 6.

²⁷ Capital Market Law 2003, Article 7.

employment functions,²⁸ while in Kuwait and Saudi they are full-time. Qatari legislation is also unlike Saudi²⁹ and Kuwaiti³⁰ legislation regarding the post of the chairman and the chief executive. In the Qatari authority, they are separate posts, while in Kuwait and Saudi, they are the same. According to Article 17 of the Qatari Law 2012, since the chief executive shall not be a member of the board appointed by Emiri Decree upon a proposal from the governor, the chairman of the board suggests the name of the chief executive.

Despite the fact that Qatari legislation has successfully separated the chairman from the chief executive, two important points have been ignored. First, the members of the board are not full-time, which may cause a conflict of interest and a lack of complete knowledge of the nature of their functions. Second, the chief executive is not a member of the board, which may cause poor communication with the board.

In the UK, by comparison, the board that governs the FCA is appointed by several parties.³¹ A chair (non-executive member), a chief executive³² and at least one other member are appointed by the Treasury. The Bank of England Deputy Governor for prudential regulation is a non-executive member of the board. Two members are appointed jointly by the Secretary of State and the Secretary of the Treasury (non-executive members). The majority of the board members must be non-executive members.

²⁸ Qatar Financial Market Authority Law No. 8 of 2012, Article 6.

²⁹ In Saudi, according to Article 11 of the 2003 Law, the same person holds the positions of chairman of the board and chief executive.

³⁰ In Kuwait, according to Article 8 of Law No. 7 of 2010, the same person holds the positions of chairman of the board and chief executive.

³¹ Financial Services Act 2012, Schedule 1ZA s2.

³² The chief executive of the FCA is also a member of the PRA governing body under the Financial Services Act 2012 Schedule 1ZB s3.

The appointment of the board members is subject to the Code of Practice for Ministerial Appointment to Public Bodies 2012.³³ The GCC countries have no such code, and there is no limit to the numbers on the board. Currently, the FCA board is made up of four executive members and eight non-executive members.³⁴ The roles of the chair and the chief executive are not exercised by the same person.³⁵ The 2012 Act does not explicitly provide for the separation of the two posts, but section 3 of Schedule 1ZA mentions that the chair is to be a non-executive member. In the UK, the Treasury determines the terms of service of the board members³⁶ and has the power to remove the appointed members in some circumstances.³⁷ The remuneration in the UK for non-executive board members is determined by the Treasury, while the remuneration for the executive board is determined by the FCA.³⁸

With regard to the age of retirement of the board members, Kuwait's Article 10 of the 2010 Law states the reasons for a board member vacating a position as death, disability or resignation. It also mentions a number of circumstances that will require a person to vacate his or her position, one of which is the issuance of a final judgment about the person's bankruptcy. Therefore, the article does not include the age of retirement, which is a subject of dispute. While Kuwaiti law extends the age of retirement of judges,

³³ Sir David Normington, the Commissioner for Public Appointments, who is independent of the civil service and the government and is appointed by the Queen, says: 'My role as a regulator is to ensure the best people get appointed to public bodies free of personal and political patronage'. The code of practice for ministerial appointment to public bodies 2012 focuses on three basic principles: merit, fairness and openness. <<http://publicappointmentscommissioner.independent.gov.uk/>> accessed 22 February 2014.

³⁴ <<http://www.fca.org.uk/about/structure>> accessed 11 January 2014.

³⁵ FCA Report 'Corporate Governance of the Financial Conduct Authority Adopted by resolution of the Board' (2013) 5. <<http://www.fca.org.uk/static/documents/fca-corporate-governance.pdf>> accessed 9 January 2014.

³⁶ Financial Services Act 2012, Schedule 1ZB s3.

³⁷ *ibid* Schedule 1ZA s4.

³⁸ Financial Services Act 2012, Schedule 1ZA s7.

prosecutors, and the Fatwa and Legislature,³⁹ the situation is not same for the board members. As a result, there is no extensive regulation of retirement age, and the age of retirement is not included as a reason for vacating a position. It could be said that there is no retirement age for the board members in Kuwait, and the age is subject to the Emir, since he appoints them. The retirement age in Kuwait is 60. Experienced people over 60 still have a lot to offer and can fulfil a useful role.

6.2.2.2 Funding Arrangements

The following discussion concerns the regulatory authorities' budget, financial resources and maintaining reserves.

In Kuwait, the Authority has an independent budget⁴⁰ that does not need to be adopted by the relevant minister. However, in Saudi, according to Article 14 of Law 2003, the Authority has a separate annual budget that is submitted by the Minister of Finance. In Qatar, the Authority's budget is part of the state's general budget.⁴¹ Therefore, the budgets of the Saudi and Qatari authorities are part of the government budget system, while in Kuwait, the authority has an independent budget, because it is not part of the government's general budget and does not need any approval. However, some argue that this is not the case with other authorities, such as the Youth and Sport Public Authority⁴² and the Public Authority for Investment.⁴³ The full independence of the regulatory authority budget is resented by some people, who feel that it should be subject to some of the same restrictions as other authorities. An example is discussed in an article published on 10 November 2013 entitled 'Budget war is renewed between the

³⁹ According to the Emiri Decree No 124 of 1992 concerning degrees and salaries of judges, prosecutors, and the Fatwa and Legislature.

⁴⁰ Capital Market Law 2010, Article 18.

⁴¹ Qatar Financial Market Authority Law No. 8 of 2012, Article 2.

⁴² Emiri Decree No 43 1992, Article 10.

⁴³ Emiri Decree No 47 1982, Article 10.

Authority and the Ministry of Finance'. The Kuwaiti Ministry of Finance insists that the Authority's budget should be approved by the Minister of Finance, while the Authority asserts that its budget is not subject to the approval of the Ministry of Finance.⁴⁴

In Kuwait, the financial resources of the Authority mentioned in Article 19 of the 2010 Law include (1) fees and (2) all other resources that are raised from exercising its activities or recruiting its reserves. Consequently, in Kuwait, there is no funding by the government. However, the Saudi authority is partly funded by the government and partly by industry. Article 13 of Law 2003 determines the financial resources of the Authority, including (1) fees for services and commissions charged by the authority; (2) fees for using its facilities; (3) a return on its funds and proceeds from the sale of its assets; (4) fines and financial penalties for breaching the 2003 Law; (5) funds provided by the government; and (6) all other resources determined by the board. The Qatari Authority is also partly funded by the government and partly by the industry. Article 23 of Law 2012 determines the financial resources of the authority, including (1) financial assistance by the government; (2) fees for services charged by the Authority; (3) fines and financial penalties for breaching the 2012 Law; and (4) all other resources that are raised by the Authority from the exercise of its activities or from recruiting its reserves.

In Saudi, the Authority should maintain a general reserve that is equal to double the amount of the previous annual budget. Surplus funds should be remitted to the Finance Ministry.⁴⁵ In Kuwait, Article 21 of the 2010 Law gives the Authority the power to maintain sufficient monetary reserves to ensure its financial stability over the long term without any limitation and transfer the surplus to the state public treasury. In Qatar, Article 23 of the Law 2012 gives the Authority the power to maintain sufficient monetary reserves to ensure its financial stability over the long term without any limitation. Unlike Kuwaiti and Saudi law, the Qatari legislation does not mention transferring the surplus to the state public treasury.

⁴⁴ <<http://www.alraimedia.com/Articles.aspx?id=464717>> accessed 10 February 2014.

⁴⁵ Capital Market Law 2003, Article 14.

The Kuwaiti and Qatari authorities are allowed to use their reserves, while this is not allowed in Saudi.⁴⁶ In Kuwait, this is inconsistent with the text of Article 24, which states that the Authority shall not engage in any commercial activities, lend money, or issue or invest in securities. Therefore, how can it use its funds?

In comparison, in the UK, the financial services companies, which are regulated, completely fund the FCA. It also has the power to keep sufficient reserves.⁴⁷ It does not receive any government funding. However, civil penalties go to the Treasury after deducting the enforcement costs.⁴⁸ In Saudi and Qatar, the funding from civil penalties is part of the financial resources, which could cause a conflict of interests because the authority might be tempted to increase the number of financial penalties prompted not by a civil wrong but by the need to boost its revenue for budgetary reasons.

6.2.2.3 Accountability

In this context, independence does not mean freedom from accountability. The following section addresses to whom a regulatory authority reports.

In the UK, the FCA is an independent body, but it is accountable to the Treasury. For example, the FCA must prepare a report for the Treasury at least once a year, and the Treasury must then submit this report to Parliament.⁴⁹

⁴⁶ According to Article 4 of the Capital Market Law 2003, the Authority does not allow any of the following four actions: (1) engaging in any commercial activities; (2) acquiring, owning or issuing securities; (3) lending or borrowing funds; and (4) being part of any project to earn profits.

⁴⁷ FCA Article 'Power to raise fees' <<http://www.fca.org.uk/about/how-we-are-funded/fees>> accessed 2 January 2014.

⁴⁸ Financial Services Act 2012, Schedule 1ZA s20.

⁴⁹ Financial Services Act 2012, Schedule 1ZA s11.

In Qatar, the regulatory Authority must report to the Governor of the Central Bank.⁵⁰ In Saudi, the Authority has to report to the President of the Council of Ministers⁵¹; in Kuwait, the Authority is overseen by the Minister of Trade and Industry⁵² and must report once a year to the relevant minister and submit the report to the cabinet.⁵³

While some may consider reporting to someone to be different to being overseen by that person, this is not the case in Kuwait. For example, the Youth and Sport Public Authority is overseen by a minister,⁵⁴ while the Public Authority for Investment also reports to a minister.⁵⁵

In Kuwait, according to Article 22 of the 2010 Law, the Authority is committed to keeping its accounts and records. This is also the situation in Qatar.⁵⁶ In the UK, the FCA is responsible for recording and safe-keeping all decisions made in the exercise of its functions,⁵⁷ and a record of each governing body meeting must be published.⁵⁸ It would be better if Kuwaiti law required publication of the Authority's meeting reports to achieve transparency. There is a saying that 'sunshine is the best disinfectant'.

⁵⁰ 2012 Law, Article 3.

⁵¹ 2003 Law, Article 4.

⁵² 2010 Law, Article 2.

⁵³ *ibid* Article 25.

⁵⁴ Emiri Decree No 43 of 1992, Article 1.

⁵⁵ Emiri Decree No 47 of 1982, Article 1.

⁵⁶ 2012 Law, Article 26.

⁵⁷ Financial Services Act 2012, Schedule 1ZA s9.

⁵⁸ *ibid* s10.

Qatari Law 2012 Article 27 says that the Authority is subject to control by the Audit Bureau; in Kuwait, the Authority is subject to control by the Audit Bureau⁵⁹ after the event and not prior to the event.⁶⁰ The Saudi law does not mention any prior or subsequent control. In the UK, the FCA must send its annual accounts to the Comptroller and the Auditor General to be examined, certified and a report made about these accounts, after which the Comptroller and the Auditor General must send a copy of the report to the Treasury, after which the Treasury submits a copy of the certified accounts and the report to Parliament.⁶¹

In conclusion, Kuwaiti law gives the Kuwaiti Capital Market Authority financial and administrative independence, especially with respect to board appointments and its budget and financial resources. In contrast, Saudi law gives administrative independence in terms of appointing the board, while the financial resources and its budget remain under government control. Qatari law does not give the Authority complete independence in terms of appointing the board, its budget and its financial resources.

6.3 Sound Legal Framework

A regulatory framework that protects investors must have laws, rules and codes, which have been defined in Chapters 3, 4 and 5 respectively. The regulatory framework needs to have a legal basis (laws, rules, codes) and effective monitoring or policing of compliance and enforcement of any breach of the laws, rules or codes. These two roles are usually in the hands of a specialised body or a regulatory authority. In the UK, these roles are performed by the FCA and the PRA. In the Gulf, such a body is usually referred to as a Capital Market Authority.

⁵⁹ The Kuwaiti Audit Bureau reports to Kuwait's Parliament, aiming to maintain effective control over public funds. Article 3 of Law No 30 of 1964 concerning establishing the Audit Bureau states that financial control includes, *inter alia*, public bodies of state with a legal personality.

⁶⁰ Capital Market Law 2010, Article 23.

⁶¹ *ibid* (n 57) s15.

Generally speaking, when a financial system works well, it will help people. However, sometimes bad behaviour, deliberate or unintentional, occurs that includes action in the market, such as market abuse; action by a business itself, such as bad behaviour by one or more managers; and action by others, such as majority shareholders, who have more power than the small consumers, including minority investors on the stock exchange.

A regulatory authority that oversees the capital market has a further role to play in that it can suggest continuous improvements in securities legislation as companies and others find more ways to circumvent the law at the expense of the investors. In addition to suggesting improvements to the law, a regulatory authority can make ‘rules’ that have the force of law.⁶² This is also known as secondary legislation.⁶³ In the UK, there are two categories of legislation. Primary legislation consists of ‘statutes’ that are enacted by Parliament. The second category consists of secondary legislation, known as ‘delegated or subordinate legislation’, which occurs when the law-making power is delegated by Parliament to a minister or local authority or semi-public organisation.⁶⁴ The legislation that gives the rule-making power is called the Parent Act.⁶⁵

Therefore, there is primary and secondary legislation, and a regulatory authority can recommend changes to primary legislation and implement secondary legislation.

⁶² The law gives the regulatory authority in the GCC countries the power to make rules similar to the UK. In Kuwait, Article 4 Part 1 states that the authority board shall issue rules and regulations that are necessary to implement this law. In Saudi, Article 6 Parts 2, 12, and 13 of Saudi Law 2003 mentions that the authority shall issue regulations, decisions, and instructions and shall set procedure. In Qatar, the board shall issue various regulations to achieve its objectives according to Article 8 Part 4 of Law 2012. In the UK, one of the FCA’s functions is rule-making according to the Financial Services Act 2012 Part 1A inside Part 2 Section 1B, 6, and the same Act also gives the Prudential Regulation Authority (PRA) the power to make rules.

⁶³ Paul Nelson, *Capital Markets Law and Compliance: the Implications of MiFID* (Cambridge University Press 2011) 4.

⁶⁴ Emily Finch, Stefan Fafinski, *English Legal System* (4th edn, Pearson 2013) 10.

⁶⁵ <<http://www.soas.ac.uk/library/subjects/law/research/file70251.pdf>> accessed 28 February 2015.

6.3.1 How Can A Regulatory Authority Help to Improve the Law?

In Chapter 3, entitled ‘Insider Dealing’, this thesis discussed securities law as one example of financial crime. This section will consider how a regulatory authority can improve the quality of the law to combat this crime effectively.

Several improvements can help the enforcement system, such as expert judges and criminal authorities who are expert in financial matters⁶⁶ and case settlement. These are the key to effective enforcement that increases the level of confidence and credibility.⁶⁷ These three issues: expert legal professionals, the court system,⁶⁸ and private enforcement are beyond the scope of the thesis.

One feature of financial crimes is the difficulty involved in enumerating them, because they vary from state to state and from time to time.⁶⁹ Many activities can be classed as financial market crime, one of which is market abuse. Furthermore, market abuse covers a wide range of illegal deeds.⁷⁰ Therefore, an authority should suggest improvements to the law that are as wide-ranging as possible to protect investors.

This is the situation in the GCC countries. In Kuwait, Article 4 Part 1 mentions that the board shall issue recommendations and studies to develop laws that help to achieve authority objectives. In Qatar, according to Article 8 Part 8 of Law 2012, the board shall suggest laws that assist the authority’s goals. In Saudi, although Saudi Law 2003 does

⁶⁶ Ana Carvajal, Jennifer Elliott, *The Challenge of Enforcement in Securities Markets: Mission Impossible?* (International Monetary Fund (IMF) working paper 2009) 18.

⁶⁷ *ibid* 21.

⁶⁸ For example, Kuwaiti Law No. 7 of 2010 mentions Article 108 to Article 116 for establishing a specialised court for securities activities called the Capital Market Court. The details of these Articles are beyond the scope of this study.

⁶⁹ Montasser Hamouda, *Economic Crimes* (Dar Elgamaa Elgadida 2010) 53.

⁷⁰ Stuart Bazley, *Market Abuse Enforcement and Procedure* (Bloomsbury Professional 2013) 3.

not mention any power to suggest laws, Part 4 of Article 6 allows the authority to give advice and recommendations that would protect investors in securities.

The situation is different between the GCC countries and the UK. In the UK, the regulation is not limited to securities. Banks, insurance companies and financial advisers are all regulated. In contrast, in the GCC countries regulation is limited to the securities market alone.

One function of a regulatory authority is intelligence, which is a two-part task. One part is alerting the authority about potential concerns; the second is gathering evidence.⁷¹ The first part, which is supervisory in nature, means discovering breaches of regulations. Supervision programmes aim to identify, deter and prevent problems. Sometimes, it is hard to distinguish among these tasks. The term ‘enforcement to compliance’ is used for the two parts of the authority’s task.

A clear mandate to enforce the laws and regulations should be granted to the authority by the securities law.⁷² In the UK, the FCA has a wide range of enforcement powers, including the imposition of criminal, civil or administrative sanctions against companies or individuals who do not meet the required standards.⁷³ This is not the case in the GCC countries. Each will be considered in turn.

It is not helpful to list all possible abuses in financial markets. In the UK, dealing with financial crime is a very important objective of the FCA authority. One way is to involve the firms in fighting this crime by monitoring, detecting and preventing financial crime, such as fraud, money laundering, bribery and corruption, and disclosing

⁷¹ *ibid* 67.

⁷² Ana Carvajal, Jennifer Elliott (n 66) 13.

⁷³ <<http://www.fca.org.uk/firms/being-regulated/enforcement/how-we-enforce-the-law>> accessed 15 February 2014.

false or secret information.⁷⁴ In addition, an enforcement programme aims to detect and punish non-compliance and to deter such action in the future. This includes investigating, obtaining evidence and interviewing witnesses, gathering information from third parties such as telephone companies and Internet providers, and accessing bank accounts. All of these actions require that the regulatory authority have the legal power to carry them out.

In the UK, the power of investigation includes such varied action as sanctions for failure to comply under section 177 of the FSMA 2000, gathering information under section 165, obtaining search warrants under section 176, and interviewing witnesses. For example, in an insider dealing investigation, two kinds of persons can be interviewed. The first is a potential witness. The interview with such a person can be compulsory or voluntary. The second kind of person is the subject of the investigation.⁷⁵ In addition, although disclosing the details of customer accounts is not generally allowed in the UK, section 175 FSMA 2000 allows it in certain circumstances. A study of these circumstances is beyond the scope of this thesis.

Unlike the UK, the situation in the GCC countries needs to be improved. The situations in Saudi, Qatar and Kuwait are all different. In Saudi, Article 5 Part c of Saudi Law 2003 gives the Authority the power to investigate, take evidence, and subpoena witnesses. Part 12 of Article 6 gives the Authority the power to conduct inquiries and investigations. However, these powers are for enforcement of the 2003 law's provisions, regulations and rules. Therefore, the scope of the power is limited to applying Law 2003. It would be better if these powers were applicable for every breach of the financial markets. In Qatar, the Authority has the right to investigate, inspect⁷⁶ and prove by all means, including electronic devices.⁷⁷ In Kuwait, Article 3 Part 6 of Law

⁷⁴ FCA Article 'Fighting Financial Crime' <<http://www.fca.org.uk/about/what/protecting/financial-crime>> accessed 2 January 2014.

⁷⁵ Sarah Clarke, *Insider Dealing: Law and Practice* (Oxford University Press 2013) 244- 247.

⁷⁶ Qatari Law 2012, Article 32.

⁷⁷ *ibid* Article 39.

2010 mentions that the Authority aims to ensure compliance with laws and regulations related to securities activities. However, Kuwaiti Law 2010 distinguishes between the Authority's right to bring a civil or commercial case and referring the complaint to a public prosecutor. The complaint is for any law, while the former is limited to the Act 2010. It would be better if the authority's powers were extended to all laws that apply to the financial markets and not just securities laws.

6.3.2 Rule Making by a Regulatory Authority

Rules are part of the legal and regulatory framework.⁷⁸ Chapter 4 of this thesis, entitled 'Fair Disclosure', discussed rules in detail. This section will talk about the advantages and disadvantages of rulemaking.

Secondary legislation has advantages:⁷⁹

- 1) Saving parliamentary time, since rules are made without Parliament's involvement. Rules are an alternative to Acts of Parliament. Accordingly, they reduce the statutory burden.⁸⁰
- 2) Speed, by avoiding the lengthy stages involved in parliamentary procedures. Whilst having the force of law, rules are quicker to pass than a statute.
- 3) Expertise needed in complicated areas. For example, making rules that regulate the economy requires an understanding of how the economy operates.

Alexander Justham, the chief executive of the London Stock Exchange, emphasised the importance of rules by saying that 'one of the crucial roles any regulator plays is to

⁷⁸ Paul Nelson (n 63) 3-4.

⁷⁹ < <http://www.lawmentor.co.uk/resources/essays/discuss-advantages-delegated-legislation-form-law-making/> > accessed 28 February 2015.

⁸⁰ Paul Nelson (n 63) 20.

examine the marketplace and potentially intervene through rule changes to ensure that an appropriate equilibrium is consistently achieved'.⁸¹

In addition to these advantages, a regulatory authority can impose civil fines for violations. For instance, in the UK, the FCA can impose a fine of any amount for breaching the rules. It is a disciplinary function. However, in Kuwait, the authority cannot impose any civil sanctions. Both civil and criminal sanctions should be available for effective enforcement,⁸² because the burden of proof required to impose a criminal sanction is higher than the burden to impose a civil sanction. Administrative (civil) sanctions differ from criminal fines sanctions. For example, in Kuwait the Capital Market Authority has to refer to the court in order to impose fines. However, there is a limit of 100,000KD for criminal fines. This difference can be clearly seen from the case in February 2014 against the Chairman of Al Ahli Bank who traded based on inside information related to the shares of Al Ahli Bank. The first instance court fined him 1.5 million KD, but the appeal court reduced this to 100,000 KD.⁸³

The disadvantage is that delegated rule-making power could have a negative effect in terms of accountability according to the separation of power.⁸⁴ Generally, to prevent abuse of power, the executive, legislative and judiciary's powers should be separate.⁸⁵ Rule-making power results in legislation which has not been fully debated in Parliament.⁸⁶ Generally, the process of passing a law involves the legislature enacting

⁸¹ Article entitled 'New Listing Rules Protect Investors and Safeguard London's Open Markets' (2013) <<http://www.cityam.com/article/1384224375/new-listing-rules-protect-investors-and-safeguard-london-s-open-markets>> accessed 18 January 2014.

⁸² Ana Carvajal and Jennifer Elliott (n 66) 19.

⁸³ <<http://www.reuters.com/article/2014/03/03/ahli-bank-kuwait-court-idUSL6N0M01DK20140303>> accessed 2 March 2015.

⁸⁴ <<http://www.lawteacher.net/free-law-essays/english-legal-system/uk-constitution-excessive-concentration-of-power.php>> accessed 1 March 2015.

⁸⁵ <<http://www.essay.uk.com/free-resources/essays/law/constitution-prerogative-powers.php>> accessed 1 March 2015.

⁸⁶ Emily Finch and Stefan Fafinski (n 64) 11.

the law, the executive carrying out the law, and the judiciary resolving disputes about the law. If the law is not clear, judges must interpret the law and, if there is an ambiguity, determine the meaning of the law.⁸⁷ However, courts will not question a law enacted by Parliament if the law is clear and unambiguous.

However, the situation with secondary legislation is different. The courts are not competent to interpret rules, because the courts would need to understand the regulatory authority's views, intentions and policy.⁸⁸ However, a court has the power to strike down a secondary regulation if the regulator exceeds its sphere of competence.⁸⁹

6.3.3 'Comply or Explain' Regime

Thus far, this section has discussed what is sometimes referred to as 'Hard Law'. This means that the law is binding, authoritative and effective, with penalties for its breaches. However, a regulatory authority can also use so-called 'Soft Law',⁹⁰ which is the name given to statements of principles, codes of conduct, codes of practice and guidance.⁹¹ It is possible to mix hard and soft law, as in the corporate governance code in the UK. Although complying with the code is voluntary, listed companies are required to explain every instance of non-compliance.⁹² This is referred to as the 'comply or explain' regime. This was discussed in detail in Chapter 4.

⁸⁷ <<http://cw.routledge.com/textbooks/9780415566957/legislation.asp>> accessed 1 March 2015.

⁸⁸ Paul Nelson (n 63) 5-6.

⁸⁹ <<http://www.lawmentor.co.uk/resources/essays/delegated-legislation-controlled-parliament-itself-and-judges-explain-judicial-controls-delegated-legislation/>> accessed 1 March 2015.

⁹⁰ Although there are no financial penalties for breaching soft law, it can play a significant role in achieving a regulatory authority's objectives. However, this is beyond the scope of this thesis.

⁹¹ William Twining and David Miers, *How to Do Things with Rules* (5th edn, Cambridge University Press 2011) 43.

⁹² If the companies do not comply, they will breach the listing rules.

A ‘comply or explain’ regime can be described as an alternative way to achieve strong regulation. It strikes a balance between soft law and hard law that can be suitable in today’s complex economic world. The ‘comply or explain’ approach has both advantages and disadvantages. Michelle Edkins, who works in the field of corporate governance as Managing Director of Corporate Governance and Responsible Investment at BlackRock Inc., summarises the advantages and disadvantages of this system by saying that:

...“comply or explain” has its limitations, poor explanations, differences of opinion between management and shareholders, different views as to the right approach amongst shareholders, lack of resources for engagement, and limits on the scope of some shareholders to be pragmatic. Nonetheless, “comply or explain” offers more flexibility than the alternative. Companies have the opportunity to set out their case and, whether agreement is reached or not, engagement helps build mutual understanding. Communication about the future involves indicating plans to adopt and improve, which, for shareholders - the institutions and the private savers among our clients - provides reassurance that companies are being run for the long-term and in the interests of the shareholders.⁹³

In addition to investors, companies would benefit from a corporate governance code. According to the chairman of the London Stock Exchange, Chris Gibson-Smith, ‘Companies benefit from visible, strong corporate governance practices by attracting more investors and so reducing the cost of capital for all’.⁹⁴

⁹³ Michelle Edkins, ‘Comply or Explain, An Essay on the Report Titled: Comply Or Explain: 20th Anniversary of the UK Corporate Governance Code’ (London Stock Exchange, The Financial Reporting Council Limited 2012) 18.

⁹⁴ Chris Gibson-Smith, ‘An Essay on the Report Titled ‘Comply Or Explain’: 20th Anniversary of the UK Corporate Governance Code’ (London Stock Exchange, The Financial Reporting Council Limited 2012) 6.

‘Comply or explain’ means more flexibility in the application of the set of rules with no free passes for avoiding these rules. Companies are required to provide an explanation, and others, such as future investors and institutional investors, will judge and monitor. Although there is no action from a regulatory authority if the explanation is insufficient, the market forces the shareholders to take action. The share price will force the shareholder to engage. Investing is about taking risks. An investor who buys stock in a company with high standards of corporate governance is less likely to lose money. This is discussed more fully in Chapter Five. Investment advisers will also take the statement of a code into account when giving advice.

The market in general and the shareholders specifically, force the companies to follow the code.⁹⁵ Simply, the process for shareholders is that if no one wants to buy the company’s shares, then the price will decrease, which prompts the shareholders to try to correct the situation. Consequently, the decline in the share price encourages the firm to adopt good corporate principles. The process is similar to the idea of market power on competitive policy that drives firms to improve their prices and services.⁹⁶ Shareholders will consider this noncompliance when deciding to buy, vote, hold and sell their shares.⁹⁷

The Code is under development. The Chairman of the Financial Reporting Council, Baroness Sarah Hogg, acknowledged that although the UK Code benefits the market, such as making a difference in the corporate culture, there is still work that needs to be done to develop the Code further.⁹⁸ Andrew Keay criticised the ‘comply or explain’ regime, because no regulatory body assesses the companies’ statements and there is no

⁹⁵ Andrew Keay, ‘Comply Or Explain: In Need Of Greater Regulatory Oversight’, (2012) SSRN Working paper <http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2144132> accessed 22 February 2014.

⁹⁶ Massimo Motta, *Competition Policy: Theory and Practice* (Cambridge University Press 2009) 41.

⁹⁷ David Seidl, Paul Sanderson, John Robert ‘Applying “Comply Or Explain”: Conformance with Codes of Corporate Governance in UK and Germany’ (2009) University of Cambridge working paper.

⁹⁸ Essay ‘Comply Or Explain: 20th Anniversary of the UK Corporate Governance Code’ (2012) London Stock Exchange, The Financial Reporting Council Limited 4-5.

way to measure the extent to which these principles actually work, such as statistics. Shareholders do not really engage in monitoring their companies.⁹⁹ He suggested introducing regulatory oversight to examine whether each company complies and whether the explanations are adequate.¹⁰⁰

One response to Keay's comment is that the content of the explanation is not important. For example, in Germany, the corporate governance code works under the 'comply or disclose' approach, under which the firms comply with the recommendations or disclose their noncompliance.¹⁰¹ In the 'comply or disclose' approach, firms comply or just say they will not comply. Secondly, some provisions of the code are already in rules or law and are mandatory. The 'comply or explain' regime is part of a large regulatory system. The code can be used as clear evidence of not complying with other rules and laws. The third point is that there is already a mechanism for judging the adequacy of an explanation under the Stewardship Code, under which institutional investors must take action if they deem that an explanation is inadequate and they have to comply or explain any failure to take action. The Stewardship Code aims to help institutional investors (on behalf of clients and beneficiaries) to exercise their responsibilities properly under the 'comply or explain' regime. Therefore, institutional investors will monitor their investee companies under a 'comply or explain' regime by, for example, giving a timely written explanation if, after careful consideration, they do not accept the company's position.¹⁰² There is no stewardship code in the GCC countries. It would be better if there were a code under a 'comply or explain' system in these countries, which would rely on family companies to take action. The fourth point concerns enforcement of compliance by a regulatory authority. More rules will affect market competition. This is discussed in more detail in Chapter 4.

⁹⁹ Andrew Keay (n 95).

¹⁰⁰ *ibid.*

¹⁰¹ David Seidl, Paul Sanderson, John Robert (n 97).

¹⁰² According to Principle 3 of the UK Stewardship Code 2012; 'Institutional Investors Should Monitor Their Investee Companies' <<http://www.frc.org.uk/Our-Work/Publications/Corporate-Governance/UK-Stewardship-Code-September-2012.pdf>> accessed 19 January 2014.

6.4 Creating Strong Investors

The Organisation for Economic Co-operation and Development (OECD) recommended education and complaints handling principles to be part of high-level principles in terms of protecting financial consumers.¹⁰³

In Principle Five the OECD mentions that:¹⁰⁴

Financial education and awareness should be promoted by all relevant stakeholders and clear information on consumer protection, rights and responsibilities should easily accessible by consumers. Appropriate mechanisms should be developed to help existing and future consumers develop the knowledge, skills and confidence to appropriately understand risks, including financial risks and opportunities, make informed choice, know where to go for assistance, and take effective action to improve their own financial well-being.

It goes on to state that:¹⁰⁵

Jurisdictions should ensure that consumers have access to adequate complaints handling and redress mechanisms that are accessible, affordable, independent, fair, accountable, timely and efficient. Such mechanisms should not impose unreasonable cost, delays or burdens on consumers. In accordance with the above, financial services providers and authorised agents should have in place mechanisms for complaint handling and redress. Recourse to an independent redress process should be available to address complaints that are not efficiently resolved via the financial services providers and authorised agents' internal dispute resolution mechanisms. As a minimum, aggregate information with respect to complaints and their resolutions should be made public.

¹⁰³ 'G20 High-Level Principles on Financial Consumers Protection' (2001) OECD Working Paper.

¹⁰⁴ *ibid.*

¹⁰⁵ *ibid.*

Investors should take some responsibility for protecting themselves either through education or by using a complaints process or both. A regulatory authority can play a significant role in ensuring that investors receive clear and adequate information about the market, the risk and their rights. This also includes increasing investors' ability to receive financial advice in an easy way. In addition, enhancing public awareness and understanding of financial systems is a key to protecting investors.

Education is not just limited to investors, but should also include various parties, such as firms' managers, advisers, brokers, and the like, because many people do not know the effects of their actions. For example, although insider dealing is a crime and has many negative effects on the market and on people's lives, some people think that there is nothing wrong with insider dealing. Chapter 3 has more on this point.

Having an adequate complaints handling and redress mechanism is a key point in terms of protecting investors. If the voice of investors is heard in a quick and fair way by taking into account the complex financial markets, the degree of protection will improve. Despite the success of arbitration in the private sector, the principle of inviolability of the sovereignty of the state presents an ongoing barrier to arbitration. It has been proven that countries are reluctant to use it.¹⁰⁶ However, protecting investors by alternative civil law resolution of disputes is compulsory for firms, while it is optional for investors.

Before looking at the Kuwait, Qatar and Saudi systems of education and complaint, it would be useful to have a brief look at the UK system as an example of the system used in a developed country.

6.4.1 Investors' Complaints and Education in the UK

Ease of lodging complaints and education are the keys to enabling investors to protect themselves. The following is a discussion of the complaint and advice systems in the

¹⁰⁶ Benn Steil and Manuel Hinds, *Money, Markets and Sovereignty* (2009) 30.

UK and the role of the FCA in this respect. Accordingly, this section will not go into further details on how the scheme of complaint and education is operated. It looks at regulation and supervision with help from the FCA.

6.4.1.1 Financial Complaints in the UK

The Financial Ombudsman Service (FOS) was set up by Parliament to solve problems for individuals. The FOS has a statutory function. Its main role is, as an alternative to the civil court,¹⁰⁷ to resolve disputes quickly, fairly, reasonably and informally. The scheme includes three jurisdictions:¹⁰⁸ the first is the compulsory jurisdiction; the second is the consumer credit jurisdiction; and the third is voluntary jurisdiction.

The compulsory jurisdiction covers complaints against authorised firms to settle individual disputes between consumers and businesses that provide financial services. The investor is always free to go to court instead of accepting the FOS decision, which is binding on the firm if the investor accepts it.

The role of the FOS is to investigate individuals' complaints and to deal with them on behalf of individual consumers; the FCA cannot do such things. The FCA ensures that the regulated firms meet the standards set by the FCA's objectives, and it takes action against these firms for any breaches. This means that the FOS handles individuals' cases, and the FCA takes supervisory and regulatory action.

¹⁰⁷ < http://www.financial-ombudsman.org.uk/about/MOU_with_FCA-APRIL2013.pdf> accessed 23 January 2014.

¹⁰⁸ Jurisdiction is the authority to hear a particular class of cases and to declare a judgment. It is a practical power granted to a legal body to best serve and achieve justice. It is like subject matter jurisdiction. Courts have the previous jurisdiction and in personam jurisdiction.

<<http://www.buteralaw.com/newsletters.asp?c=49&id=450>> accessed 12 February 2014.

The FOS offers a free service without taking sides and gets involved if the firm is not able to resolve a dispute. Consequently, the firm is given a chance to solve the dispute itself. In addition, various matters can be referred to the Financial Ombudsman Services, such as stocks, shares, units and bonds, banking and pensions. The FOS does not pass rules or impose fines.¹⁰⁹

According to the Memorandum of Understanding between the FCA and the FOS, the FOS is responsible for operating the Ombudsman Scheme and for appointing the ombudsmen, while the FCA is responsible for appointing the FOS board, making the rules and approving the FOS budget.¹¹⁰ The FOS operates independently from the FCA, but the FCA ensures the capability of the FOS to exercise its functions.

According to the Annual Report 2012/2013, the number of cases handled by the FOS each year has increased over the last decade from 62,170 new cases in 2003 to 508,881 cases in 2013.¹¹¹ This indicates that people increasingly trust this method of resolving disputes.

The FOS is funded by levies and case fees paid by financial businesses. It is free for investors, and for firms it is free for the first 25 cases. Thereafter, firms are charged £550 per case.¹¹² The FOS is a public body that provides a service to the public. The FOS was created to put things right for consumers with valid complaints against businesses providing financial services. It has two primary functions. The first is to impose 'Money Awards', which are the compensation that businesses violating the rules must pay to the financial consumers. The FOS decides the amount of money required to

¹⁰⁹ <<http://www.financial-ombudsman.org.uk/>> accessed 23 January 2014.

¹¹⁰ <http://www.financial-ombudsman.org.uk/about/MOU_with_FCA-APRIL2013.pdf> accessed 23 January 2014.

¹¹¹ <<http://www.financial-ombudsman.org.uk/publications/directors-report-2012-13.pdf>> accessed 23 January 2014 8.

¹¹² <<http://fca.org.uk/firms/being-regulated/meeting-your-obligations/firm-guides/organisations/fos>> accessed 2 February 1014.

resolve the complaint. The second consists of ‘Directions’, by which the FOS tells businesses to put things right by taking particular steps.

There are a number of ways that the FOS settles complaints:¹¹³ Nine out of ten disputes are settled informally. One and sometimes both parties want to rely upon the official power of the FOS to solve the disputes. If the consumer does not accept the decision within the time allowed by the FOS for this purpose, the decision is not binding. If the decision is accepted by the consumer, this decision is binding on both parties. It is a final stage for the firms, because there is a legal requirement with a parliamentary function to comply with the decision as quickly as possible. If the business is unable to pay, the matter may be referred to the Financial Services Compensation Scheme (FSCS) as a final safety net when businesses are not able to pay what they owe. Businesses may refuse to comply with final decisions, although, in practice, this cannot happen. Although the FOS has no power to enforce the decision if a business refuses to pay an award, a) the FCA has the power to force businesses to comply; and b) the court has the power to force the businesses, because the decision is legally enforceable in court according to Schedule 17. The court will not re-open the case if it is just for enforcement. The consumer will have to go to court to enforce the decision. This indicates that the consumer is free to go to court until he has accepted the decision. However, there is a debate over the right to go to court after accepting the offer but this debate is beyond this thesis.

6.4.1.2 Financial Education in the UK

In 2010, a new body was established, the Consumer Financial Education Body (CFEB). One of its functions is to help members of the public to understand financial matters and to manage their finances better.¹¹⁴ The CFEB is an independent body that provides information, advice and education.

¹¹³ ‘What a “Final Decision” by an Ombudsman Means’ Paper, Financial Ombudsman Service.

¹¹⁴ New Section 6A of the Financial Services Act 2010.

The CFEB was established on 1 March 2010, although it changed its name to the Money Advice Service on 4 April 2011 for the year ending 31 March 2013, according to the Annual Review, the Director’s Report and Financial Statements.¹¹⁵ The Money Advice Service is different from Citizens Advice in that the latter provides free, independent, confidential and impartial advice to everyone who faces any problem, not just a financial one. Section 4 of the FMSA 2000 mentions that promoting public understanding of the financial systems is the objective of public awareness. However, in 2012, the Financial Services Act replaced the FMSA 2000 to enhance the public’s understanding and knowledge of financial matters.¹¹⁶ The Financial Services Act 2010 provided that, in particular, the CFEB must enhance the provision of information and advice to the public.¹¹⁷ Through the twin statutory objectives, the Money Advice Service (formerly the CFEB), which was launched in April 2011 as a company limited by guarantee, dealt with 2.1 million customers during one year from 1 April 2012 to 31 March 2013.¹¹⁸

Although the Money Advice Service has statutory functions, it is accountable to the FCA on some points. According to a framework document that was signed in 2013 by the Money Advice Service, the FCA, and the UK Treasury, the FCA has different responsibilities from the Money Advice Service, such as appointing and removing the

¹¹⁵ < <https://www.moneyadviceservice.org.uk/en/static/publications>> accessed 26 January 2014.

¹¹⁶ Financial Services Act 2010, explanatory notes.

¹¹⁷ Financial Services Act 2010, s2 Part 6A(e).

¹¹⁸ < <https://www.moneyadviceservice.org.uk/en/static/publications>> accessed 26 January 2014.

Type of Service	Number of customers
Face-to-face meetings with customers	100,000
Telephone contact	81,000
Web chats	15,000
Action plans delivered	1.2 million
Debt advice sessions funded through partners in England and Wales	158,000
Total Number of customers	2.1 million

board, approving the annual budget, levying sums and receiving an annual report. The FCA is able to monitor some of the Money Advice Service's activities, such as providing the FCA with sufficient information, its capability of exercising its functions and having regular meetings.¹¹⁹ The primary source of funding is from industry. The FCA raises and collects the money on behalf of the Money Advice Service.

Education in financial skills could affect individuals, families and society as a whole. For example, education and improving financial capability could help to eliminate child poverty by early intervention and financial support.¹²⁰ Education in financial skills is not limited to making good financial decisions. Mark Taylor says that financial skills could affect people's psychological wellbeing and their mental health, savings behaviour, living standards, and household income.¹²¹

6.4.2 The Situation in Kuwait, Qatar and Saudi

After looking at the situation in the UK, the following concerns the situation in Kuwait, Qatar and Saudi.

6.4.2.1 Individuals' Dispute Resolution in Kuwait, Qatar and Saudi

Under financial regulations, various regulatory instruments can be breached, including laws, rules, and codes. (1) If the law is breached by a firm or an individual, the case is

¹¹⁹ <<http://www.fca.org.uk/static/documents/mou/mas-fca-hmt-framework-document.pdf>> accessed 22 January 2014.

¹²⁰ According to a paper submitted to the government's consultation on its child poverty strategy from the consumer financial education body (CFEB) in February 2011.

<<https://www.moneyadviceservice.org.uk/en/static/publications>> accessed 26 January 2014.

¹²¹ Report 'The Long Term Impacts of Capability: Evidence from the BHPS' (2011) Consumer Financial Education Body.

<http://www.educationscotland.gov.uk/resources/l/genericresource_tcm4662873.asp> accessed 26 January 2014.

sent to the criminal court. It would be better if there were special judges for this court. The special judges, the court system and private enforcement of laws are beyond the scope of the thesis. (2) If an individual's rights are breached by a firm or an individual, the case is sent to the civil court. (3) It is important to find an alternative to civil court litigation to resolve disputes, because an alternative resolution body would help to resolve disputes that arise in a complex financial market, such the FOS in the UK. (4) If the Authority's rules are breached, the case is sent to a disciplinary committee. Sometimes, the case will be sent to the upper tribunal. (5) If the code (a combination of soft and hard law) is breached, there are two possibilities. If the breach was of the Authority's rules and, for example, the company does not disclose or explain under the UK Code 2012, it will be referred to the disciplinary committee; if the disclosure or explanation is made, but the explanation is not sufficient, the market itself will punish the company by playing a role in enforcement. In the alternative, the UK Stewardship Code provides that, in the 'comply or explain' system, institutional investors can take action against an insufficient explanation. 6) If a soft law was breached, no financial penalties are assessed. Therefore, one of the mechanisms for protecting individual rights is to have an alternative resolution body.

In Saudi, the Authority must establish a committee to resolve securities disputes.¹²² It is specialised in civil and criminal cases. It receives complaints from the Authority or from individuals. It has three responsibilities: (1) as a civil and criminal court; (2) as a disciplinary committee for breaching the law and the rules; and (3) as a dispute resolution committee relating to individuals. It is a competent court in disputes involving securities. However, its scope is limited to the 2003 Law and its regulation and rules are provided in Article 25 of the 2003 Law.

It would be better if the Saudi legislature had created a committee for disciplinary sanctions that did not include criminal sanctions and had established a separate operational body to resolve individual disputes relating to securities transactions that would work as an alternative to a civil court, similar to the UK's FOS. It would also be

¹²² Saudi Capital Market Law 2003, art 25.

better if there were no limit to pursuing those who breach the Law 2003 or its regulations and rules.

Qatari Law 2012 Article 30 Part 10 mentions that the board shall introduce all regulations, rules and decisions regarding the establishment of mechanisms to resolve disputes that may arise from securities activities. This includes two mechanisms, the first of which involves the committee settling disputes by arbitration or other methods of alternative dispute resolution. The second mechanism is a disciplinary committee for violations of the provisions of the Law 2012 and the rules and regulations. Qatari law has succeeded in distinguishing between the disciplinary committee and the committee on dispute resolution. However, both are part of the Qatari Authority. It would be better if the committee on dispute resolution were not operated as part of the Qatari Authority to ensure impartiality.

In Kuwait, Article 5 Part 2 provides that the Authority shall receive complaints about the violations provided under Kuwaiti Law 2010, which means that complaints should be limited to breaches of the law. However, the law extends the scope of complaint in the Kuwaiti Act 2010 Article 15, which mentions that the Authority creates a committee to receive complaints and grievances and that every interested individual has the right to submit a complaint to the committee.

The above shows that the complaint scheme is part of the Kuwaiti Authority. It would be better a separate body were introduced to do this work, as in the UK.

In Kuwait, failure to comply with Article 148 of the 2010 Law can be settled through arbitration in disputes related to transactions on the capital market. The Kuwaiti Authority has issued a dispute settlement system, which entered into force in April 2014. This system is voluntary and does not include a compulsory jurisdiction system, which is an alternative to civil litigation and a factor for investor protection. The scope of the Kuwaiti system is limited to commercial and investment disputes that the

consumer wishes to resolve, and the dispute is related to the 2010 Law and other laws about capital market transactions.

6.4.2.2 Education in Kuwait, Qatar and Saudi

Before looking at the situation in the GCC countries, an example will show how a good education can affect financial markets and help to change behaviour regarding finance.

Anna Bernasek compared the milk industry and the financial market. She observed that, in the past, people fell ill and some died as a result of milk, but they no longer do so. People drink milk without even thinking about whether the milk is safe.¹²³ She thinks that this is because people rely on other people and their integrity to ensure that milk is safe. In addition, the farmer thinks about the long term, and people's integrity is much more important than personal benefits.¹²⁴

In a lecture entitled 'Behavioral Finance and the Role of Psychology', Robert Shiller expressed his belief that the successful business focuses on long-term advantage instead of concentrating on the weak points of people's behaviour.¹²⁵ From this, it can be learned that the regulatory authority can educate people to use the power of thinking about the long term instead of short-term value. In addition, education can improve people's integrity in business. For example, some people still think that there is nothing wrong with some types of market abuse, such as insider dealing. However, if they knew that people are hurt by insider dealing, they might change their opinion.

¹²³ Anna Bernasek, *The Economics Of Integrity: From Dairy Farmers to Toyota, How Wealth is Built on Trust and What that Means For Our Future* (Harper Studio 2010) 17.

¹²⁴ *ibid* 35.

¹²⁵ Robert Shiller (n 3).

In Kuwait, Article 3 Part 2 of Kuwaiti Law No 7 of 2010 states that one of the regulatory authority's aims is to educate the public on securities' activities, risks, and liabilities associated with investing in securities and to encourage development. In addition, Article 5 Part 6 of the Kuwaiti Act 2010 mentions that the regulatory authority shall print and publish materials relating to securities' activities. The education scheme is part of the Kuwaiti Authority, but it would be better if the Authority adopted a separate body to do this work as in the UK.

In Qatar, raising public awareness regarding securities activity and developing the investment in such activities are two of the Authority's aims according to Article 5 Part 3 of Qatari Law 2012. It seems that the law associates development with public awareness, and the goal to raise public awareness is intended to develop the market and not protect the investor. It would be better if there were separate ideas for public awareness and for market development.

In contrast to Kuwait and Qatar, Saudi legislation does not mention public awareness in the regulatory authority's aims.

To sum up, the creation of strong investors in Kuwait, Qatar and Saudi is still in its infancy. Their regulatory authorities can play a significant role by creating an education and complaints body and by passing rules or suggesting laws to the legislature, as is done by the FOS and the Money Advice Service organisations in the UK. One problem is that the legislation in the GCC countries is limited to securities markets, while in the UK, the role extends to other areas of the financial market. It would be better if one body were responsible for education and for facilitating the lodging of complaints about the financial systems as a whole in the GCC, as happens in the UK.

6.5 Conclusion

This chapter has dealt with the protection of investors from the view of having sound regulatory authority under the 2010 Act. Most countries have a regulatory authority to regulate their capital market. This chapter has discussed how to have a sound regulatory

authority, which must be effective and efficient to protect investors. For a regulatory authority to protect investors effectively, it must be independent, introduce sound regulation, and create strong investors. Each of these three points has been reviewed.

A regulatory authority for securities in Kuwait was established only recently. To assess its adequacy, this thesis compared it with the system in the UK, which has existed for much longer. The Kuwaiti Act describes the regulatory authority as an independent body. Although the term ‘independence’ is used, careful analysis of the text showed the extent to which this independence is true.

The regulatory framework that protects investors must have laws, rules and codes, and it must have effective monitoring and policing of compliance and enforcement of breaches of the laws, rules and codes. This thesis looked at the advantages and disadvantages of rule-making. In addition to ‘Hard Law’, which means that the law is binding, authoritative and effective, with penalties for its breaches, a regulatory authority can also use ‘Soft Law’, which refers to rules, regulations and codes that are not binding. It is possible to mix hard and soft law, as in the corporate governance code in the UK. Although complying with the code is voluntary, listed companies are required to explain every instance of non-compliance. Some advantages and disadvantages of the comply-or-explain approach have been discussed.

This chapter also discussed the role that a regulatory authority can play in ensuring that investors receive clear and adequate information about the market, the risks and their rights. This also includes increasing investors’ ability to receive financial advice in an easy way. In addition, enhancing public awareness and understanding of the system is a key to protecting investors.

Chapter Seven

Conclusion and Recommendations

This last chapter completes the thesis. The following is a summary of the main findings, recommendations for reform and recommendations for further research.

7.1 Findings of the Study

It has been the primary motivation of this thesis to investigate and discover whether Law No 7 (the Kuwait Capital Markets Act 2010) has given individual investors more protection than previous laws and, if appropriate, suggesting amendments to the law. A secondary aim has been to improve the Kuwaiti people's knowledge about securities and to serve as a basis for further research within this field. To answer this question, the following areas have been analysed. The paper consists of seven chapters.

7.1.1 Chapter 1: Introduction

Chapter One identified the way to achieve the thesis's aims in terms of the methodology, the thesis structure and limitations, and the scope of the thesis, which was limited to the protection of individual investors on the Kuwaiti Stock Exchange under securities law. This chapter found that although some people believe that there is no need to regulate the stock exchange, the reality is that there is a greater move toward intervention in and regulation of the markets. For example, in Kuwait in the 1980s the government believed in a free market, but this resulted in the Suq al-Manakh Crisis, following which it passed several laws to regulate the stock exchange, the most recent being the 2010 Act.

A stock exchange is a type of self-regulatory organisation. There are several models for regulating stock exchanges. Self-regulatory organisations (SROs), such as stock exchanges that govern themselves without outside interference, have been developed over time. This research has found that many developed countries regulate their financial markets using the 'Government Model', in which securities regulation lies with a public authority, and the exchanges' supervision of their markets is limited. The UK uses this model, whereby the London Stock Exchange is self-regulating and the FCA regulates securities. Kuwait adopted the same model in 2010.

Even though the system of law in the UK is different from that in the GCC countries, the financial legislation relies on statutory provisions and not case law; thus, it is similar to the codified systems in the GCC, including Shari'ah law. This enables a direct comparison to be made between the financial regulations of the UK, Kuwait, Qatar and Saudi Arabia.

Economists are dedicated to formulating theories, in this case of markets and their regulation. The need for regulation has been demonstrated, for example, by numerous financial crises and scandals, from which Kuwait has not been immune. Regardless of the theories, the reality is that financial crises have occurred, and people have suffered as a result. The crises in Kuwait could probably have been avoided by having sound regulation in place.

7.1.2 Chapter 2: The concept of protecting investors under securities laws

The 2010 Act does not state how to protect investors and does not even define 'investors'. Therefore, Chapter Two analysed the concept of protecting investors under securities laws by looking at the areas of investors, securities, securities law and protecting investors. This thesis has explained that there are several types of investors, such as individuals, institutions.. The scope of the thesis was narrowed to protecting individual investors regardless of their nationality or whether they are minority or

majority investors. See figure 7.1 below. It is not appropriate to consider sophisticated and unsophisticated investors since the thesis is about investors in shares and not other more risky instruments where the level of sophistication is important.

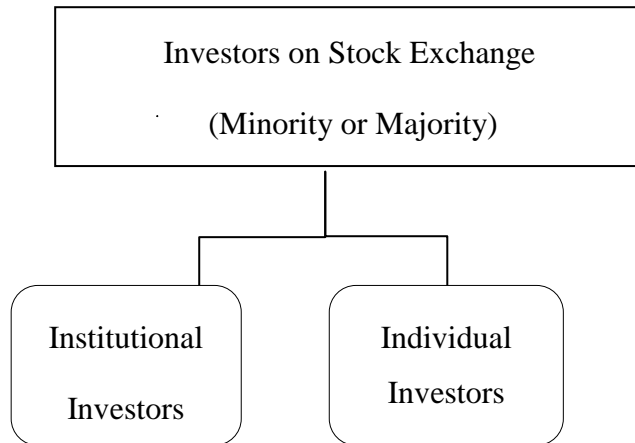


Figure 7.1: Types of investor

Chapter Two also defined securities and compared them with commercial paper. Securities law is part of financial regulation. However, some countries, such as the UK, regulate securities as a part of the whole financial system called ‘Financial Regulation’, while other countries, such as the GCC, regulate securities through separate and special laws called ‘Securities Laws’. Regulations for protecting investors are not limited to securities law. There are other sources of laws that protect investors, such as bribery law, company law and accounting law. This thesis defined securities law and introduced financial regulation and other laws that protect investors. Chapter Two also compared securities markets with traditional markets.

As mentioned above, in this thesis, the definition of investors does not include speculators or businesses but is restricted to ordinary persons, who try to ensure a good future for themselves and their families by improving their standard of living, obtaining a good education for their children and protecting the value of their savings. An individual investor in the UK is viewed as a consumer of financial products or services

(See Figure 7.2 below). In contrast, Kuwait, Qatar and Saudi do not define individual investors.

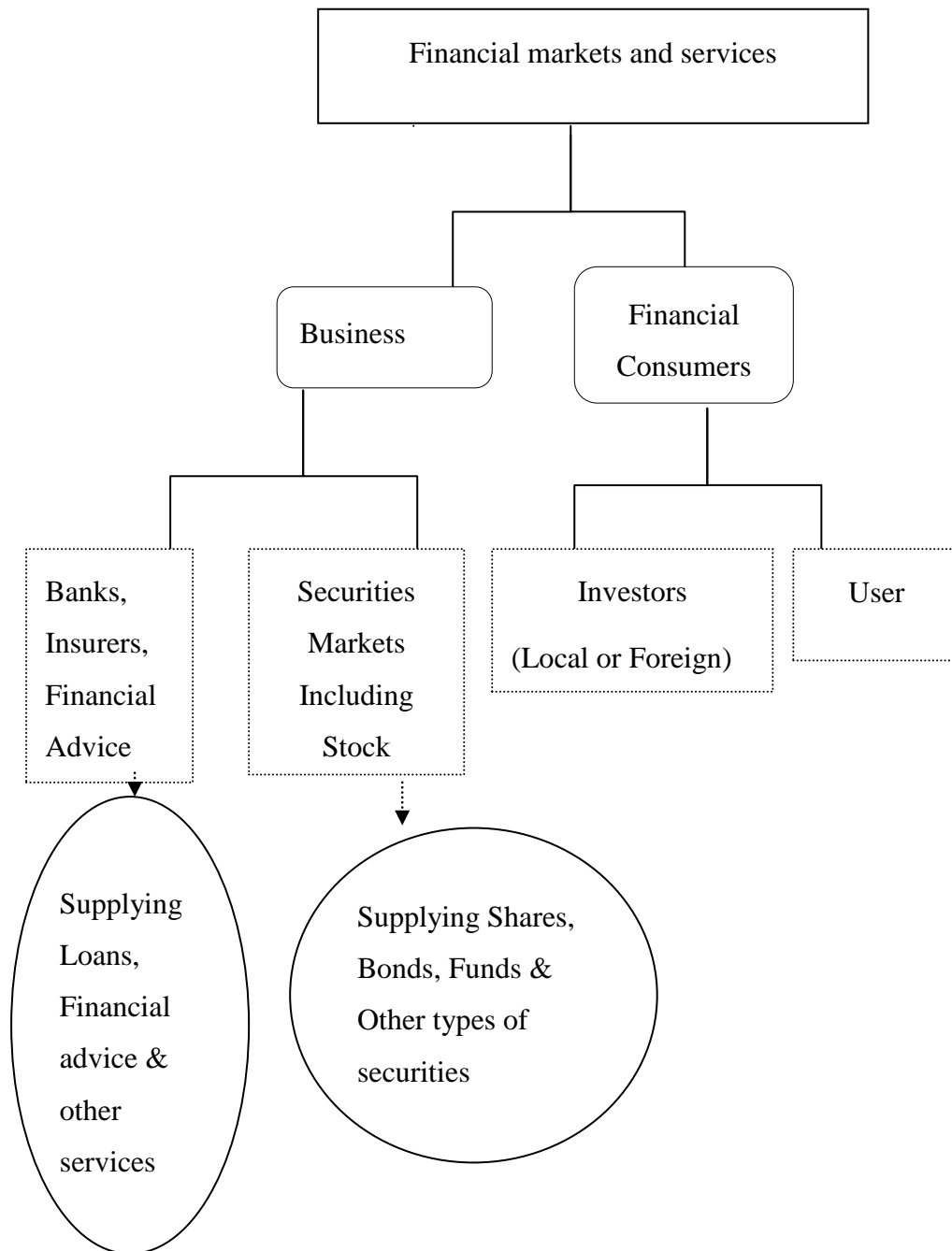


Figure 7.2: Investors as a type of financial consumer in the UK.

There is no clear statement of what ‘protecting investors’ means. This thesis addressed the problems from the view of what investors are looking for. The first task is to find a fair price that has not been influenced by market abuse, as addressed in Chapter Three.

The second task is to provide equal opportunities to learn important information. The third task is to protect investors from bad behaviour by managers and the fourth is to have sound securities regulation that protects investors. Investors can be divided into different types, for example individual investors and institutional investors, each of which requires a different form of protection. In the UK, individual investors in listed companies, which are the subject of this research, are classed as consumers of financial products and services. This gives them more protection than institutional investors. However, in Kuwait, no distinction is made between individual and institutional investors.

Generally, the securities markets need special regulation because of their nature. In developed countries, the methods used to protect the securities market differ from those used to protect the traditional market for goods and services. This was what the Kuwaiti legislature intended when they passed a new act in 2010 to regulate the securities market.

The banking crisis in the UK has led to a change in the way regulation was viewed by creating two types of regulation, namely prudential regulation and regulation of the conduct of business. Prudential regulation is about controlling the solvency and liquidity of participants in financial markets. Regulation of the conduct of business focuses on the relationship between firms and customers and includes preventing market abuse and ensuring that firms treat their consumers fairly. Prudential regulation can be separated into macro-prudential regulation and micro-prudential regulation. In the UK, before and during the financial crisis of 2008 there was a conflict between prudential supervision and conduct of business supervision. It was difficult for one body to reconcile them. The diagram below (Figure 7.3) shows the key improvements in financial market regulation in the UK.

1- **Prudential Regulation** is about controlling the solvency and liquidity of banks & investment firms.

2- **Conduct of business regulation** focuses on conduct, compliance and promoting competition & integrity with the aim of protecting consumers.

Figure 7.3 stylised diagram of Key Improvement in Financial Market Regulation in the UK.

Regulations for protecting investors are not limited to securities law; there are other laws. Protection is also provided under bribery law (such as the UK Bribery Act 2010), company law (such as the UK Companies Act 2006) and accounting law. In terms of accounting law, the concept of protecting investors requires there to be fair representation and professional judgement by having good accounting legislation. This should cover three points, namely: good accounting reporting standards, professional auditors that express their opinion and state any misstatement and a single independent body to set and enforce accounting standards.

7.1.3 Chapter 3: Insider Dealing

Chapter Three dealt with the first aspect of investor protection – insider dealing. Insider dealing has a long and controversial history with regard to securities laws, because some people believe that insider dealing should not be banned by law, such as Professor Manne. However, nearly every country bans insider dealing, although it is done in different ways. This chapter discussed the two principal arguments for and against insider dealing. The argument in favour of insider dealing, known as the ‘Manne Argument’, is an economic argument, while the argument against insider dealing is based on moral and fairness principles.

This chapter discussed the existing legal framework for the regulation of insider dealing in the Kuwait, Qatar, Saudi and the UK stock markets. It also looked at American law, because the United States has a long history and extensive experience in this regard. Three important issues were identified that must be addressed to deal effectively with insider dealing: defining the activity, sanctions, and enforcing civil or criminal liability.

Information is very important when buying or selling in the stock market, because information can materially affect the value of the securities. Decisions whether to buy or sell are based on information collected from the market. Insider dealing involves the use of information that is not disclosed to the public.

The key to passing effective legislation against insider dealing is to define it properly. The definition of insider dealing has to cover the following four areas: who is an insider; what is inside information; how is inside information transferred; and what action is banned. In the past, 'insiders' were divided into two categories, primary insiders and secondary insiders. Nowadays, much of the legislation defines insiders differently as it does not distinguish between primary and secondary insiders.

The insider dealing laws of the US and the UK are quite different and both were used as a comparison with the Kuwait Act 2010. The US situation is complicated by the evolution of many theories over time and by the complex manner in which the American legal system addresses insider dealing with common law, statutes and SEC rules. In the US, establishing insider dealing requires proof of breach of a fiduciary duty. In the UK, however, a fiduciary duty does not have to be breached. Insider dealing is defined more clearly than in the US. One overriding difference between the American and English regimes governing insider dealing is in the promulgation and application of the law. The US has a general statute that does not define insiders or inside information. Consequently, judges are allowed to develop common law prohibitions. In contrast, the UK has a statute with a specific prohibition. To improve their own legislation, it is suggested that the GCC countries should follow the example of the UK rather than that of the US.

The main advantage of the 2010 Act is that it provides criminal sanctions through provisions set out in Chapter 11, which makes insider dealing a crime. However, there are still shortcomings, such as the lack of a clear definition of insider trading. Moreover, the Act provides up to seventeen different kinds of administrative penalties, including a caution or warning, but it does not include any financial penalty. By comparison, the sanctions available to the FCA in the UK include an unlimited financial penalty. Applying administrative sanctions is easier than applying criminal sanctions. However, a criminal sanction is a major deterrent to insider dealing. Therefore, there is a need for both types of sanctions.

In conclusion, to answer the research question in terms of insider dealing, the 2010 Act partly succeeds in protecting investors by banning insider dealing. However, the Act does not define insider dealing properly, and there are some problems in enforcing insider dealing, as mentioned above.

7.1.4. Chapter 4: Fair Disclosure

The 2010 Act gives the regulatory authority the power to pass disclosure rules. However, the Act does not mention how to improve such disclosure rules. Therefore, Chapter Four discussed the second aspect of protecting individual investors, which involves ensuring fair disclosure by listed companies, because informed investors are protected investors. The chapter discussed the idea of having fair disclosure to protect investors to ensure that all investors have equal opportunity to access and know about inside information in an appropriate time and manner.

Chapter Four also examined the existing disclosure rules that apply to equity shares in Kuwait as compared to Qatar, Saudi and the UK's disclosure regimes as examples of developed countries. Regulation in the UK and an introduction to regulation in Kuwait Qatar and Saudi were reviewed in this chapter.

This study has found that the disclosure of inside information is governed by several rules that often overlap, such as listing and disclosure rules. Listing rules play an important role in the protection of investors. Before securities can be listed, the authorities must ensure that disclosure requirements are met. In order for the securities to continue to be listed and to facilitate the orderly operation of the stock exchange market, a complete and exact disclosure of relevant information must be made on a timely basis. The chapter also reviewed the definition of disclosure rules, how to control them and delays in full disclosure, limited disclosure, initial and final disclosure and exemption from disclosure.

This thesis has found that it is not enough simply to draft disclosure rules. Disclosure rules must also be capable of implementation. Chapter Four discussed a number of rules that have the potential to assist, namely the listing principle, director responsibilities, the insider list, the reasonable investor standard, the adviser and holiday disclosures.

Since laws must punish those who breach the information disclosure regime, the civil liability, criminal liability and administrative sanctions available have been considered. Broadly speaking, sanctions may include administrative, civil or/and criminal sanctions. The sanction framework consists of three optional penalties. Each of these sanctions has advantages and disadvantages. It is better to have a combination of these three sanctions to fight against different types of breaches.

Criminal sanctions is a deterrence model (loss of reputation or stigma) with the need for a high standard of proof. While civil and administrative sanctions are less of a deterrent with a lower standard of proof and they are not required to meet a burden of proof that is beyond reasonable doubt. Criminal liability allows the authorities to take legal action against those who have failed to comply with disclosure rules, for violation or non-compliance. Criminal sanctions should be used in certain actions such as fraud, misleading or giving false information with the intention of non-compliance with disclosure requirements. Criminal sanctions include fines and imprisonment in the most serious cases.

Civil liability governs the relations between persons or organisations. In civil liability, some laws require conditions to be met such as who will bring the evidence. The claimant has the right to take a private action through the civil court to recover compensation from persons who have breached the disclosure rules. Public enforcement can also be used when the authority files the case on behalf a company or a person. Civil sanctions include financial penalties.

Administrative sanctions are imposed by an administrative body for violation of its rules. Administrative sanctions do not involve a judicial court process and usually involve a disciplinary committee. A regulatory authority is given judicial powers to impose sanctions by law. An administrative body is not required to respect procedural guarantees such as the right to fair trial. Administrative sanctions include fines, suspension or cancellation of listing in stock markets; there is no threat of imprisonment.

Disclosure of inside information plays a significant role in protecting investors, because they rely on this information to make their investment decisions. Consequently, having fair disclosure protects investors by ensuring that all investors have equal opportunity to access and know about such information in a timely and appropriate way. Several forms of disclosure are required from listed companies, such as notification of transactions by persons discharging managerial responsibilities (disclosure of dealing); periodic reporting (annual and half-yearly reports); notification of acquisition or disposal of major shareholdings, including, for example, acquisition or disposal by issuers; and finally, disclosure of inside information.

Disclosing inside information is governed by several rules that often overlap. The first set of rules consists of listing rules for equity shares, which impose a continuing obligation for listed companies to disclose meaningful information. The second set of rules is comprised of disclosure rules, such as exist in the UK and Kuwait. The third set is comprised of market abuse rules. The fourth set is comprised of the criminal offences associated with disclosure. Like the UK, Kuwait relies on listing rules and disclosure

rules to control the disclosure of information. However, Qatar and Saudi Arabia rely solely on their listing rules to control disclosure.

Nowadays, international competition exists among stock exchanges in different countries. Importantly, the fewer the companies in the stock market, the lower are the profits realised by the stock exchange. History has shown that the conversion of stock exchanges themselves to listed companies in their own right has resulted in an increase of competition for profits, which has affected the regulation of stock exchanges. What happened in Kuwait after the passing of the 2010 Act, is that a number of companies tried to find another stock exchange for their listing with fewer listing rules.

In reality, it is a difficult challenge to identify material inside information and to determine the appropriate time to disclose it. This discussion revealed a number of criticisms of the system of continuous disclosure. It affects competition because early disclosure can reveal the company's plans and future projects to a competitor in the market. Rumours can result from delay in disclosure and from the disclosure of false information. The best way to combat rumours is to require the issuer to judge whether it needs to make a disclosure.

In conclusion, to answer the research question in terms of fair disclosure, the 2010 Act partly succeeds in protecting investors by mentioning fair disclosure as one of the Act's objectives and by giving the regulatory authority the power to promulgate rules. However, the Act does not specify how to achieve that aim, and there are some problems in enforcing disclosure rules, as mentioned before.

7.1.4 Chapter 5: Corporate Governance

Although the 2010 Act does not mention corporate governance, the regulatory authority has used its power to promulgate rules by adopting a corporate governance code. Therefore, Chapter Five addressed the third aspect of protecting investors, which

involves good corporate governance. Chapter Five narrows the scope to the governance issues handled by capital market authorities, especially the codes.

This study has found that there is no clear definition of corporate governance. The literature refers to different components of corporate governance. For example, corporate governance is dealt with in corporate law and as part of securities laws and regulations. Chapter Five focused specifically on these securities laws and regulations, as they affect investors in listed companies. It compared the provisions of corporate governance in the UK and in the three GCC countries, where, unlike the UK, there is a mixture of mandatory and voluntary rules.

Although the term ‘corporate governance’ is used every day in the financial press, it is a complex term. It relates to various fields, such as law, economics, management, accounting and others, and each field has its own developments. Poor corporate governance is a multifaceted subject that involves risk management, bribery, fraud, and poor board practice, all of which can affect listed companies. Some say that the core of the problem is the separation of ownership and control in managing other people’s money, which is an agency theory. The need for effective corporate governance rules is greater than ever before. Good corporate governance not only aims to protect investors, but it also has the potential to affect both company success overall and the success of the nation. In recent years, a number of scandals and collapses have not only reduced shareholders’ financial investment, but have also affected other stakeholders, such as employees who have lost their jobs and, in many cases, their pension funds. Better enforcement methods of corporate governance compliance can limit future lapses in corporate governance and can boost investor confidence, economic efficiency and growth. It is clear that no country is immune from such scandals and collapses, including Kuwait.

This study has found that applying corporate governance principles by means of the law can cause two problems. First, it can harm the growth of the economy. Second, a company faces financial and administrative burdens as a result of applying all corporate governance principles and, consequently, needs to employ more staff, spend more

money, and gain more legal knowledge about the way to apply these rules and how to bear the cost. Corporate governance needs to be developed over time. Corporate governance principles do not remain static, but evolve with time and must continue to develop.

Sometimes there is an overlap between the two types of legislation, namely corporate and securities legislation. When a company is listed in the same country as it is incorporated, the company will be subject to both sets of legislation. However, if a company is listed on a stock exchange in a jurisdiction other than where it is incorporated, the company will be held accountable in the jurisdiction where the stock exchange is located according to statutory instruments that apply to that stock exchange.

In the UK, the Finance Reporting Council (FRC) is responsible for publishing the Corporate Governance Code and for promoting high quality corporate governance. The FRC is an independent regulator. However, in Kuwait, the Regulatory Authority is responsible for publishing the code. The ‘comply or explain’ approach is a key feature of the UK Code. A company cannot face sanctions for non-compliance, only for not explaining its non-compliance. If the company does not mention why it did not comply with the rules of governance in its report, it is in violation of the listing rules.

The majority of the necessary corporate governance rules already exist in Kuwait, but they are not sufficiently wide ranging and have not always adequately protected investors. The securities law could enhance the enforcement of corporate governance principles that can protect investors. Corporate governance in Kuwait is lacking in two areas. First, coverage of various areas of corporate governance, such as risk management, is inadequate. Second, the methods of enforcement of the corporate governance provisions that do exist need to be improved. In Kuwait, compliance with the corporate governance code is mandatory, and failure to comply is a breach of Securities Law No 7 of 2010. Qatar has adopted a ‘comply or explain’ approach, but the explanation must be provided to the Qatari Capital Market Authority, not the shareholders, in the form of an annual report. In 2006, the Saudi Corporate Governance

Code was introduced based on the ‘comply or explain’ approach. However, over time, certain of the original provisions have become mandatory.

In conclusion, to answer the research question in terms of corporate governance principles, the 2010 Act partly succeeds in protecting investors by giving the regulatory authority the power to promulgate rules. However, there are some problems in enforcing disclosure rules, as mentioned previously. In Kuwait, the corporate governance code requirements do not distinguish between companies of different sizes. What is appropriate for a large company may not be appropriate for a smaller company, which may find it too costly to comply. However, where compliance is mandatory, all of the companies are the same. The Kuwaiti 2013 Code contains 70 pages, is very detailed, and places a heavy compliance burden on companies.

7.1.6 Chapter 6: Sound Regulatory Authority

The 2010 Act created the Kuwaiti Regulatory Authority, but the question is whether it is a sound regulatory authority. A sound regulatory authority is an important solution, as discussed in the previous three chapters in the context of the problems encountered in protecting investors. Each of these problems needs sound regulation, one method of which is establishing a sound regulatory authority that helps to solve these problems and others.

Like many other countries, Kuwait has an authority that regulates its capital market. However, this chapter discussed how to have a sound regulatory authority. Such a regulatory authority needs to be effective and efficient to protect investors. This requires independence (See Figure 7.4), the introduction of sound regulation, and the creation of strong investors. Each of these three points was reviewed.

Independence & Accountability

Freedom of Action from Political and Commercial Interference

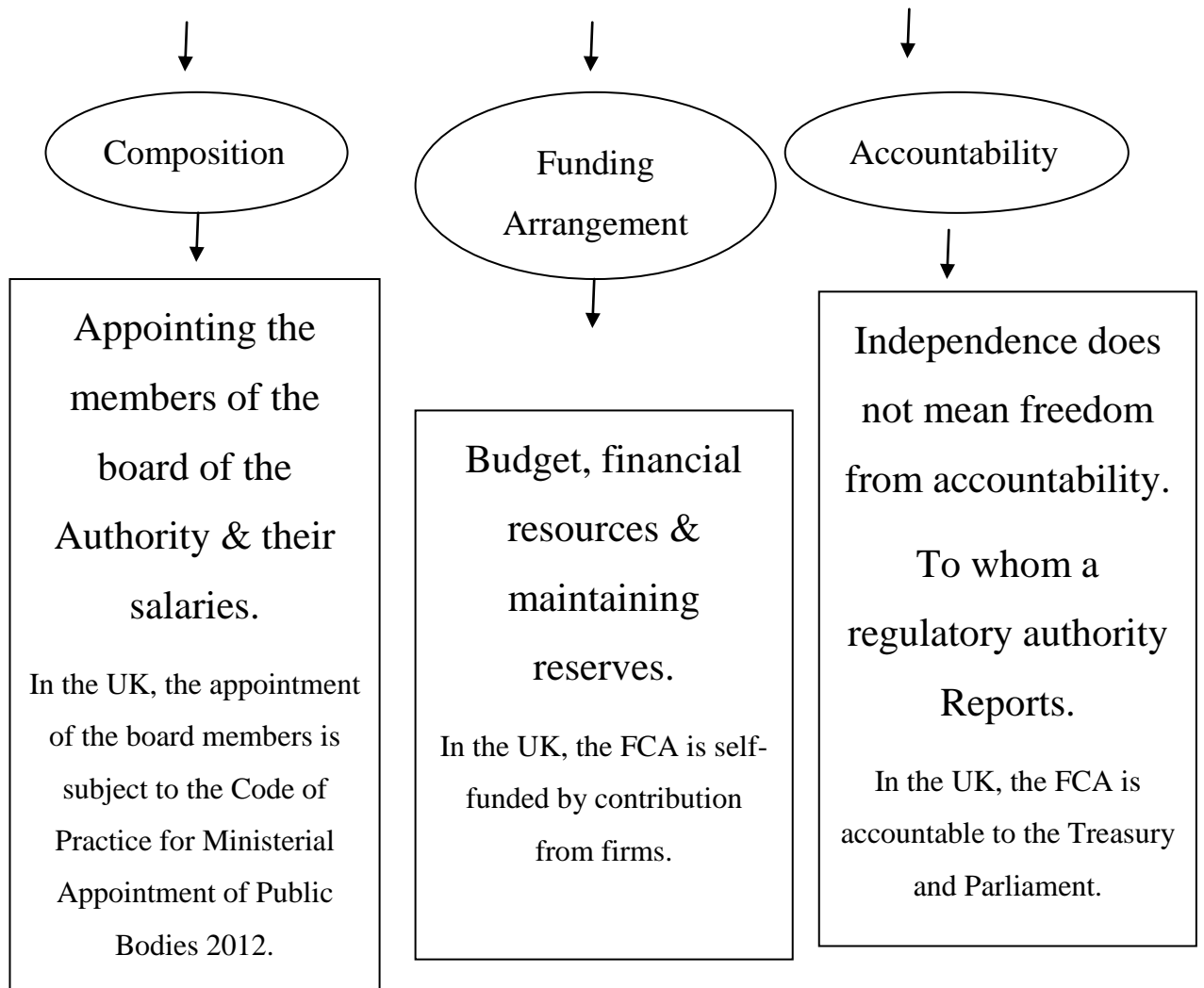


Figure 7.4 stylised diagram of an independent regulatory authority.

Securities authorities in Kuwait and other GCC countries were established only recently. To assess their adequacy, this thesis compared them with the system in the UK, which has existed for much longer. Kuwait, Saudi Arabia and Qatar describe their

regulatory authorities as independent bodies. Although the term ‘independence’ is used, careful analysis of the text was discussed to show the extent to which this is true.

The regulatory framework that protects investors must have laws, rules and codes, and have effective monitoring and policing of compliance and enforcement of all breaches of these laws, rules and codes. This thesis looked at the advantages and disadvantages of the rulemaking. In addition to ‘Hard Law’, which means that the law is binding, authoritative and effective, with penalties for its breaches, a regulatory authority can also use so-called ‘Soft Law’, which is the name given to statements of principles, codes of conduct, codes of practice and guidance. It is possible to mix hard law and soft law, as in the Corporate Governance Code in the UK. Although complying with the Code is voluntary, listed companies are required to explain every instance of non-compliance. Some advantages and disadvantages of the ‘comply or explain’ approach were discussed.

Chapter Six also discussed the role that a regulatory authority can play in ensuring that investors receive clear and adequate information about the market, the risks and their rights. This also includes increasing investors’ ability to receive financial advice in an easy way and providing an easy way to complain.

Most countries have a regulatory authority to regulate their capital markets. In the UK, it is the Financial Conduct Authority (FCA); in the GCC countries, it is the Capital Market Authority. For a regulatory authority to protect investors effectively, it must have independence, have enforcement power (See Figure 7.5), have legislative duty, and create strong investors.

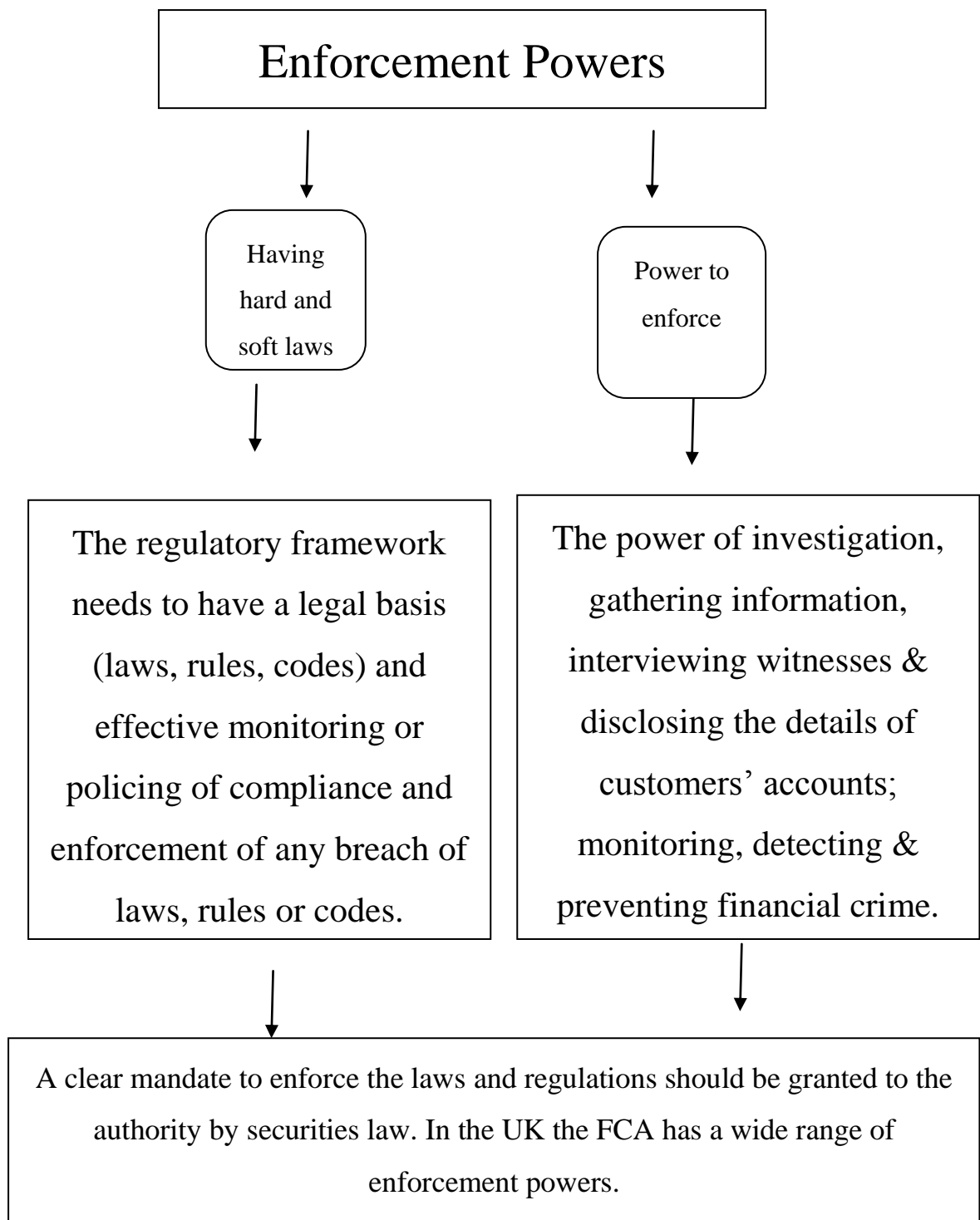


Figure 7.5 stylised diagram of enforcement powers.

A clear mandate to enforce the laws and regulations should be granted to the authority by the securities law. In the UK, the FCA has a wide range of enforcement powers, including the imposition of criminal, civil or administrative sanctions against companies or individuals who do not meet their standards. This is not the case in Kuwait. Making

rules is part of the legal and regulatory framework; such rules are known as ‘secondary legislation’. They have advantages and disadvantages. The first advantage is saving parliamentary time, since rules are made without parliament’s involvement. The second advantage is speed, by avoiding the lengthy stages involved in parliament. The third advantage is expertise in complicated areas. The disadvantage of rulemaking power is that delegated rulemaking power can have a negative effect in terms of accountability according to the separation of power. Generally, to prevent abuse of power, the executive, legislative and judiciary powers should be separate. Rulemaking power results in legislation that has not been fully debated in parliament. A regulatory authority can also use soft law. It is possible to mix hard law and soft law, as in the Corporate Governance Code in the UK. A ‘comply or explain’ regime is an alternative way to achieve strong statutory regulation. It strikes a balance between hard law and soft law that can be suitable in today’s complex economic world.

Investors should take some responsibility for protecting themselves. A regulatory authority can play a significant role in facilitating their task by ensuring that investors receive clear and adequate information about the market, the risks and their rights and to have a complaints procedure that is easy to use is a key point in terms of protecting investors. If the voice of investors is heard in a quick and fair way by taking into account the complex financial markets, the degree of protection will improve. This means that easy lodging of complaints together with appropriate education are keys to enabling the investors to take some responsibility for protection.

In the UK, the appointment of the board members is subject to the Code of Practice for Ministerial Appointment to Public Bodies 2012. Kuwait has no such code. As a result, there is no extensive regulation of the retirement age for board members, and the age of retirement is not included as a reason for vacating a position. It could be said that there is no retirement age for board members in Kuwait, and their age is an issue for the Emir, since he appoints them.

In terms of securities legislation, Saudi, Qatar and Kuwait are similar in the level of investor protection. Therefore, the comparison with Saudi and Qatar did not add more value to this research.

In conclusion, to answer the study question in terms of having a sound regulatory authority, the 2010 Act partly succeeds in protecting investors by creating the Kuwaiti Regulatory Authority. However, there are some problems in enforcing laws and rules. In addition, the Act did not establish other organisations that would assist the Kuwait Regulatory Authority. Thus, the Act has partly succeeded in protecting individual investors. On the one hand, the Act is a major step in the right direction. On the other hand, there is much room for improvement.

7.2 Recommendations for Reform in Kuwait

This research aims to assist the Kuwaiti legislature in reforming legislation to benefit those who invest in the stock market, so as to revitalise investing by protecting investors against sudden fluctuations due to fraud in the market and other threats. It may be useful to conclude by offering some important recommendations.

7.2.1 Recommendations on the concept of protecting investors

7.2.1.1 Definition of investor

In Kuwait, it would be wise to have a clear definition of an investor that is similar to that contained in the UK legislation. In the UK, the term ‘consumer’ is used instead of ‘investor’. Consumers include persons who have invested or may invest in financial instruments or who have relevant rights or interests in relation to those instruments. The securities law in Kuwait does not distinguish between individual and institutional investors and nor does it distinguish between individual investors who use financial services and those who invest in financial instruments. This needs to be addressed.

7.2.1.2 Discretionary power to Authority

In identifying the types of securities that are regulated under securities law, the Kuwaiti legislature should emulate the Saudi legislation, which gives discretionary power to the Authority board to determine what a security is. This avoids the need to amend the legislation to take into account future developments involving the creation of new types of securities.

7.2.1.3 Specific legislation covering bribery and accounting standards

In Kuwait, there is a need to pass the kind of special legislation regarding bribery that exists in the UK. Kuwait also needs to pass specific legislation regarding accounting activities that covers three issues, namely high accounting standards, professional auditors and an independent body to set up and oversee accounting activities such as the FRC in the UK.

7.2.2 Recommendations on insider dealing

7.2.2.1 Definition of insider dealing

This thesis offers a number of recommendations related to the crime of insider dealing, the regulation of which must be improved in Kuwait. In Kuwait, there are some shortcomings in the definition of insider dealing. It is important to have a clear definition of insider dealing. The optimum definition must cover the following four areas: who is an insider; what is inside information; how is inside information transferred; and what type of activity is banned. The UK's Criminal Justice Act 1993 (CJA) is a good illustration. Therefore, the definition should be improved by reference to English law, which has a fixed definition. Qatar and Saudi Arabia have defined the term, but since their definitions also have some shortcomings, it is better if the Kuwaiti legislature does not follow them. It would be beneficial for Kuwait to adopt a provision that is similar to the UK's fourth reform relating to defining insider dealing.

7.2.2.2 Fines

Although article 146 of the Kuwaiti Act 2010 provides that the disciplinary board may impose any of seventeen different kinds of penalties, including a caution or warning, it

does not include any financial penalty. It would be beneficial to give the Kuwait Capital Market Authority (KCMA) the power to impose fines.

7.2.2.3 Liability of third parties

One of the most important shortcomings in Kuwaiti legislation is that no mention is made of criminal responsibility on the part of third parties (tippees), because they are not considered to be insiders. It would be better if Kuwaiti law considered a tippee to be an insider. There is no logical reason for treating a tippee differently from an insider and this has been recognised by countries such as the UK and the US.

7.2.3 Recommendations on disclosure regime

This thesis suggests a number of recommendations related to the disclosure regime. It is important to make ideal rules that suit the nature of the stock markets.

7.2.3.1 Adopting UK listing principles

It would be wise to have listing principles in Kuwait that are similar to those in the UK. The main objective of the listing principles is to aid listed companies in identifying their duties under DTR and Listing Rules. Saudi Arabia and Qatar do not mention these principles in their disclosure rules.

7.2.3.2 More responsibility for the issuer

The best solution for controlling the disclosure of inside information is to make an issuer responsible for a disclosure. This can be clearly seen from the listing principles in the UK, which mention that adequate procedures, systems and controls must be established by an issuer (Listing Principle 2) to comply with its obligations. It would be beneficial for Kuwait to adopt a similar provision. Saudi Arabia and Qatar do not mention such rules in their disclosure rules.

Another responsibility is to require that an issuer prepares a list of insiders. It would be better if Kuwaiti legislation were to require every issuer to prepare a list of insiders and to add such a requirement to its disclosure regime. Saudi Arabia and Qatar do not mention such rules in their disclosure rules.

7.2.3.4 Fines

In Kuwait, the KCMA can apply one of the administrative penalties included in Law No 7 2010 if the issuer does not comply with the Disclosure Rules. However, administrative penalties do not include fines. It would be a good idea to add the imposition of a fine as an optional administrative penalty.

7.2.4 Recommendations on corporate governance

This thesis suggests a number of recommendations related to having a good corporate governance code.

7.2.4.1 Developing a code

An independent organisation should be established to develop a corporate governance code. For example, in the UK, the Finance Reporting Council (FRC) develops corporate governance rules, which are enforced by the FCA, formerly by the FSA. Kuwait would benefit from having an organisation like the FRC to develop a Kuwaiti code.

7.2.4.2 New framework for enforcement code

The traditional ways of enforcing corporate governance principles are not suitable for the real world today. The world needs a new framework for the enforcement of corporate governance principles. Through rules and codes, the securities laws can help to form this framework. There is a diversity of enforcement methods. Different aspects of corporate governance are enforced in different ways. Some are enforced by corporate law, while others are dealt with by securities laws and delegated legislation in the forms of rules and voluntary and mandatory codes. This thesis has shown that Kuwait needs to

balance the mandatory rules consisting of statutory requirements, such as securities laws and rules, and regulations backed by statute on one hand and the principles that operate on a 'comply or explain' basis on the other hand.

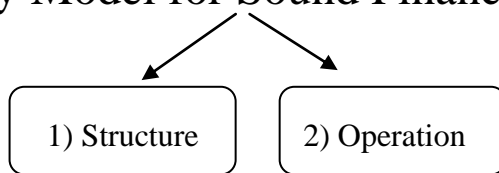
7.2.5 Recommendations on a sound regulatory authority

This thesis suggests a number of recommendations related to a sound regulatory authority.

7.2.5.1 Structure

For a financial system as a whole to be sound it needs the right structure in terms of responsibilities. The right structure in the UK is considered to be one that has separate authorities for prudential risks and the conduct of companies. Each of these bodies needs to have requirements to operate in a sound manner. Figure 7.6 shows a regulatory model for a sound financial system which is recommended for Kuwait.

Regulatory Model for Sound Financial System



1) The correct **structure** to tackle all direct & indirect risks should have:

- 1- Separate prudential & conduct regulation.
 - 2- One body responsible for conduct of business in all financial sectors not just securities.
 - 3- Consumer protection not just investors.

2) **Operational** requirements for a sound regulatory authority for conduct of business

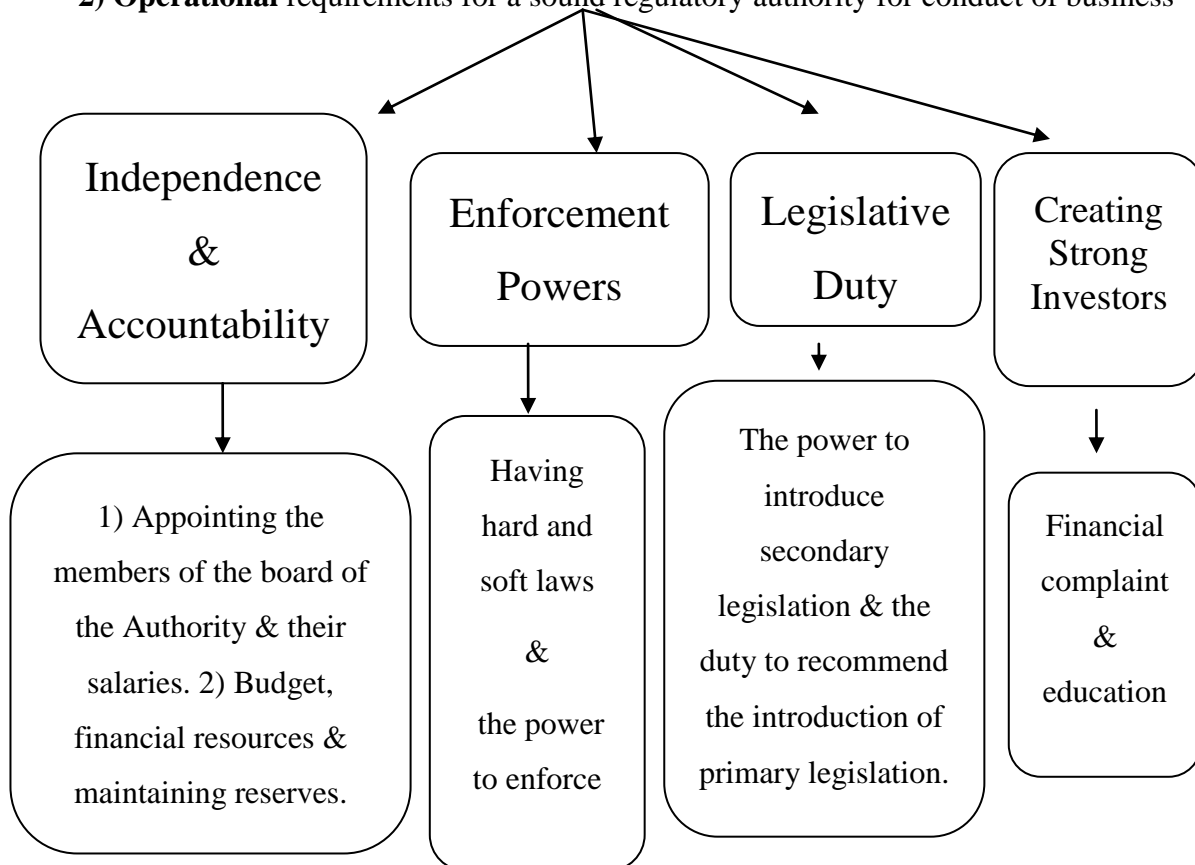


Figure 7.6 shows regulatory model for sound financial system

7.2.5.2 Publishing meeting reports

In the UK, the FCA is responsible for recording and safe-keeping all decisions made in the exercise of its functions and a record of each governing body meeting must be published by the FCA. It would be better if Kuwaiti law required the publication of the authority's meeting reports.

7.2.5.3 Educating investors and facilitating complaints

The creation of strong investors in Kuwait is still in its infancy. In the UK, the regulatory authority can play a significant role by creating an education and complaints body and by passing rules or suggesting laws to the legislature, as is done by the FOS and the Money Advice Service organisations. In Kuwait, it would be better if the 2010 Act established such organisations to assist the regulatory authority in educating investors and facilitating complaints to resolve disputes.

Furthermore, it would be better if one body were responsible to educate and to facilitate the lodging of complaints about the financial systems as a whole in Kuwait, as happens in the UK. The regulatory authority's responsibility in Kuwait is limited to securities markets, while in the UK, the role extends to other areas of the financial market.

7.2.5.4 Reforms of financial system as a whole

Regulation of the financial system in Kuwait at this moment is similar to the UK prior to the changes of 2012. Previously, the Financial Services Authority and the Central Bank were jointly responsible for financial regulation. However, as the crash of 2008 demonstrated, this did not work well because neither of the two bodies foresaw the event. As result of that crash, two distinct authorities were created to manage the financial system. Although one of the authorities is a subsidiary of the Bank of England it is still a separate authority. In Kuwait, there is a Capital Market Authority, which is partly responsible, and the Central Bank, between them they are supposed to regulate the financial system. This is different from the UK where the FCA is at least responsible for all financial services, whereas in Kuwait the Capital Market Authority is only responsible for securities and the Central Bank is supposed to regulate everything else.

It is likely that this will be more problematic in the future than it was in the UK. Table 7.1 shows a comparison between regulatory authorities in the UK and Kuwait and what the financial system in Kuwait needs in order to be at the same level as the UK financial system.

	UK	Kuwait
Prudential & Conduct Regulation	Two Separate Authorities	One Authority
Markets Regulation	All Financial Markets	Securities Market only
Who is Protected	Financial Consumer	Investors

Imposing Fines	Unlimited	No
Advice & Education	Money Advice Service body	No
Resolution of Dispute	Financial Ombudsman Services Body	No
Using Business Culture (Voluntary Codes)	Corporate Governance Code	No
Objectives	Clear	Not Clear

Table 7.1 Comparison of Regulatory Authorities in the UK and Kuwait

7.3 Recommendations for Further Research

Few studies have considered securities law in Kuwait. This thesis is one of the first studies to investigate the 2010 Act from the perspective of protecting individual investors. Therefore, more research is needed in different areas. Some recommendations for future research regarding securities law in Kuwait are as follows:

1. International cooperation

International cooperation between foreign regulatory authorities is an important subject that needs more research in terms of the type of regulations the world needs, such as a treaty that forces countries to cooperate.

2. Constitutionality of the Capital Market Authority

Further research could be undertaken into the constitutionality of establishing a Capital Market Authority in Kuwait (KCMA) and the extent to which such an Authority would conflict with Article 123 of the Kuwaiti Constitution. Article 123 mentions that ‘the Council of Ministers has control over the department of the state’. However, Chapter Six of this thesis showed that the KCMA is beyond the control of the Council of Ministers on some points.

3. The structure of financial regulatory authorities

Good organisational structure that includes broad structural features and clear managers’ activities can lead to good coordination and control within the organisation. This will achieve the organisation’s goals in the correct way, free from individual influences.¹ Therefore, the structure of a financial regulatory authority is important to achieving its objectives. The type of structure needs more research.

4. Control of investor behaviour

Sometimes investors need to be protected from themselves. According to financial behaviour studies, taking risks becomes a calling. It is human nature. Sometimes, it is like a force or a movement of strong will to take risks without stopping to think of the results.² It is a good idea to study ways to control an investor’s behaviour on a stock exchange in the field of psychology.

¹ Rhys Andrews, ‘Organisation Structure and Public Service Performance’ in Richard Walker, George Boye and Gene Brewer (Eds) *Public Management and Performance: Research Directions* (Cambridge University Press 2010) 90-91.

² Robert Shiller, *Finance and the Good Society* (Princeton University Press 2012) 139-142.

5. Stewardship Code

In the UK, it was felt necessary to introduce a stewardship code for institutional investors. It would be useful to research the feasibility and desirability of introducing such a code in Kuwait.

6. Corporate governance

Corporate governance of a regulatory authority is an important subject that needs further research. Good corporate principles lead to a number of benefits in managing the organisation. In the UK, the corporate governance framework relating to the FCA can be defined as the way in which the board is constituted, directed and controlled by the FCA.³ The Financial Services Act 2012, part 2 of 3C, states that one of the FCA's duties is to follow principles of good governance.⁴ It would be better if Kuwait had such a law.

7. Operation and powers of self-regulatory organisations

Self-regulatory organisations (SROs), such as stock exchanges, govern themselves without outside interference and are responsible for the operation of the exchanges. This includes:

- 1) regulation of market transactions, which means ensuring that the members' actions are in accordance with pre-agreed rules;
- 2) regulation of the market participants by ensuring that they do not breach their obligations by maintaining over time the value of their capital, not taking excessive risk, and not breaching ethical behaviour, and, if they breach their obligations, they will face sanctions from the SRO itself;
- 3) dispute resolution and enforcement actions that include private mechanisms that enforce good conduct.

The operation of SROs and their powers needs more research in Kuwait.

³ Report entitled 'Corporate Governance of the Financial Conduct Authority' (2013) 3.<<http://www.fca.org.uk/static/documents/fca-corporate-governance.pdf>> accessed 9 January 2014.

⁴In managing its affairs, each regulator must have regard to such generally accepted principles of good corporate governance as it is reasonable to regard as applicable to it'.

8. Political interference

Politics is one of the challenges to a regulatory authority.⁵ A strong decision-making ability is sometimes a political risk. Therefore, freedom from political interference is necessary to enable strong decision-making.⁶ In addition, a politically and commercially independent regulatory authority needs support from senior politicians.⁷ Political interference needs more research in Kuwait.

9. Financial compensation schemes

In the UK, the Financial Services Compensation Scheme (FSCS) is an organisation independent from the government and the financial industry that assists private individuals if a company is unable to pay certain claims against it, because it has stopped trading or is in default. For example, if a financial institution becomes insolvent, and an individual has investments with that institution, the FSCS would pay some compensation.⁸ This is also the case if an investor pays a broker who then defaults although the amount of the compensation in this case is lower. There is no such scheme in Kuwait. It would be a good idea to compare the situation in the Kuwait with the UK on this issue.

10. Protection of investors in securities other than shares

The scope of this thesis was limited to the protection of investors who trade in shares. Protecting investors in securities other than shares needs more research.

11. The UK and the USA Comparison

A comparison between the UK and the USA in order to find the most appropriate solution for Kuwait is a subject for further research.

⁵ Ana Carvajal, Jennifer Elliott, 'The Challenge of Enforcement in Securities Markets: Mission Impossible?' (International Monetary Fund working paper 2009) 4.

⁶ *ibid* 25.

⁷ *ibid* 26.

⁸ <<http://www.fscs.org.uk/what-we-cover/about-us/>> accessed 18 May 2014.

12. Financial education

One of the serious problems faced when establishing a regulatory regime is the shortage of suitably qualified staff, such as specialist judges, lawyers and investigators. For example, Principle 5 of the IOSCO Objectives and Principles of Securities Regulation 2010 emphasises that ‘The staff of a regulatory authority should observe high professional standards’.⁹ It would be a good idea to establish a programme to teach securities law as a main subject, whether as part of a diploma course (one or two years), a bachelor’s degree course (three or four years), or a master’s programme. Research is needed regarding the optimal course content in such fields as accountancy, law, and economics.

7.4 Final observation

This research and thesis have made proposals which will provide better protection for individual investors by making the authorities aware of a number of shortcomings in the current legislation in Kuwait. Hopefully, too, it has added more knowledge to the body of literature in the securities law field, especially for Kuwaiti scholars.

⁹ <<http://www.iosco.org/library/pubdocs/pdf/IOSCOPD323.pdf>> accessed 26 February 2014.

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Appendix 1

The FCA enforcement procedure for disciplinary cases¹

¹ <<https://www.fca.org.uk/static/documents/enforcement-information-guide.pdf>> accessed 15 September 2014.

Appointment of Investigators

We appoint investigators and, if appropriate, send a Notice Appointment of Investigators to the firm or individual. We do this as quickly as practicable.

Scoping discussion

Our initial discussions with the firm or individual are intended to provide a clear indication of the scope of the investigation, including how the process will unfold and the individuals and documents the investigators will initially need to access to

Investigation Work

The appointed investigators carry out the investigation. The investigation may include, for example, requests for documents or information and interviews of witnesses and subjects. Following the investigation work, there is an internal legal review of the case by a lawyer who has not been part of the investigation.

Preliminary Investigation Report (PIR)

If appropriate, we send a PIR to the firm or individual, who has 28 days to respond. They can apply for extra time to complete their response.

Submission to the FCA Regulatory Decisions Committee (RDC)

If, following their investigation, our staff believe action is justified they submit case papers to the RDC. This includes an Investigation Report, which takes account of the firm or individual's response to the PIR. The RDC considers the submission. The Regulatory Decisions Committee comprises practitioners and non-practitioners, who all represent the public interest. The FCA staff who handle cases before they go to the RDC will not be involved in the RDC's decision making. Members of the RDC are appointed by and are accountable to the FCA board.

Warning Notice

If the RDC decides it is appropriate, it will send out a Warning Notice informing the person concerned that the FCA intends to take further action. The firm or individual has the right to access material relied on by the RDC in taking its decision, together with secondary material which might undermine that decision. The firm or individual has 14 days to make oral or written representations to the RDC and can apply for extra time.

Oral and written representation to the RDC

After it receives the Warning Notice, the firm or individual may take written or oral representation to the RDC. The RDC will then meet again to consider the facts of the case, including the firm's or individual's written representation and any new information that may have come to light. If the firm or individual has chosen to make oral representations, they are made before the RDC at this stage.

Private Warning

We may issue a private warning at any stage in the procedure, and in doing so we close the investigation.

Settlement discussions

The parties can seek to resolve the issue by having settlement discussions with us at any stage in the procedure.

Closure

If we find there is no case to answer, we close the investigation at any stage in the procedure

If the RDC finds there is no case, either before or after representation, the FCA closes the investigation.

If after representations the RDC finds there is no case, a Notice of Discontinuance will be issued.

Published information

We may, if appropriate, publish information about certain Warning Notices (having consulted the person to whom the notice is issued).



Decision Notice

RDC makes its decision and, if appropriate, issues a Decision Notice. The firm or individual has 28 days to make a referral to the Upper Tribunal (Tax and Chancery Chamber)



Final Notice

If no referral is made to the Tribunal following the Decision Notice, a Final Notice is issued to the firm or individual concerned.

Published information

We will publish such information about the matter to which a Decision or Final Notice relates as we consider appropriate.

Upper Tribunal (Tax and Chancery Chamber): a fresh look

Following the Decision Notice, the firm or individual has the right to refer their case to the Tribunal. The Tribunal is entirely independent of the FCA and will consider the entire case afresh. A Tribunal hearing is normally held in public.

Tribunal's determination

The Tribunal decides what action the FCA should take in relation to the matter referred to it (including issuing a Notice of Discontinuance if the case is not made out)

Appendix 2

The FCA Corporate Governance
statement for the year ended 31 March
2013¹

¹ <<https://www.fca.org.uk/static/documents/annual-report/fsa-annual-report-12-13-section-9.pdf>> accessed 15 September 2014.

The FSA was a company limited by guarantee and was therefore not obliged to comply with the UK Corporate Governance Code (the Code). However, the FSMA required the organisation to have regard to generally accepted principles of good corporate governance as applicable. The Board was committed to meeting high standards of corporate governance and decided to comply with the Code as far as appropriate. This report sets out how the FSA was governed in line with the Code's principles.

The FSMA required the FSA to have a number of accountability mechanisms, including an Annual Public Meeting, and to report on the extent to which its regulatory objectives were met. The FSA was funded by the industry it regulated through its statutory fee-raising powers and it operated independently of Government, but was accountable to Parliament through obligations set out in the FSMA. Consultation with consumers and practitioners on rules and general policy was undertaken through the Consumer, Practitioner and Smaller Businesses Practitioner Panels.

The FSA was led by a Board, which developed its strategy and approved and monitored the annual operating plan and budget. Certain responsibilities were reserved to the Board for its decision and these were set out in the schedule of matters reserved to the Board. There was also a governance memorandum detailing the functions that had been delegated by the Board. The majority of the FSA Board comprised non-executive directors who, in addition to their statutory responsibilities under the Companies Act 2006, had specific obligations under the FSMA. The Board was of sufficient size to ensure that the requirements of the business could be met and that changes to the Board composition and any of its committees could be managed without undue disruption. FSMA required that there was a non-executive directors' committee (NedCo), which kept certain functions under review. Information on NedCo's work is set out in the non-executive directors' report.

The Board and Board Committees met regularly during the year and details of the number of meetings held and attendance at those meetings are set out in Table 1. The membership of the various committees can also be found in Table 1.

Before Hector Sants resigned as chief executive with effect from 30 June 2012, the roles of the FSA chair and chief executive were separate: the chair, who was independent on appointment in September 2008, led the Board and ensured its effectiveness, and the chief executive was responsible for developing and delivering the strategic objectives agreed with the Board. Between Mr Sants' resignation and legal cutover to the new regulatory system on 1 April 2013, Adair Turner acted as executive chairman.

In preparation for legal cutover, the FSA operated an internal ‘twin peaks’ structure during the year, with a Conduct Business Unit led by Martin Wheatley and a Prudential Business Unit led by Andrew Bailey.

The non-executive directors of the Board had a variety of appropriate skills and experience. Apart from any contact they may have had with the FSA as a result of being connected with a regulated firm, or as consumers of regulated products, the non-executive directors were judged by the Board to be independent of the FSA. Where any conflicts of interest arose relating to personal or business matters, procedures were in place to ensure that no director would be exposed and that decisions would be made without undue influence.

The chair ensured, with the company secretary, that the Board’s agendas were set in line with the priorities of the organisation. The company secretary reviewed papers before their circulation to Board members to ensure that information was accurate and clear. Papers for Board and Committee meetings were usually circulated one week before meetings.

Until legal cutover, one of the non-executive directors acted as chair of the non-executive directors’ committee and was viewed as the senior independent director. The non-executive directors’ committee ceased to exist in the new regulatory framework.

Directors of the FSA were formally appointed by the Treasury following a rigorous selection process. The selection panel comprised representatives of both the FSA and the Treasury and the procedures followed were in line with the principles in the code of practice issued by the Office of the Commissioner for Public Appointments.

The company secretary arranged induction for new directors that was appropriate for their knowledge and experience. The Board also received ongoing professional development on relevant issues. During the last year this included training for non-executive directors on consumer credit and platforms. Individual directors have also had personal briefings on other topics, such as interest-only mortgages, before Board meetings.

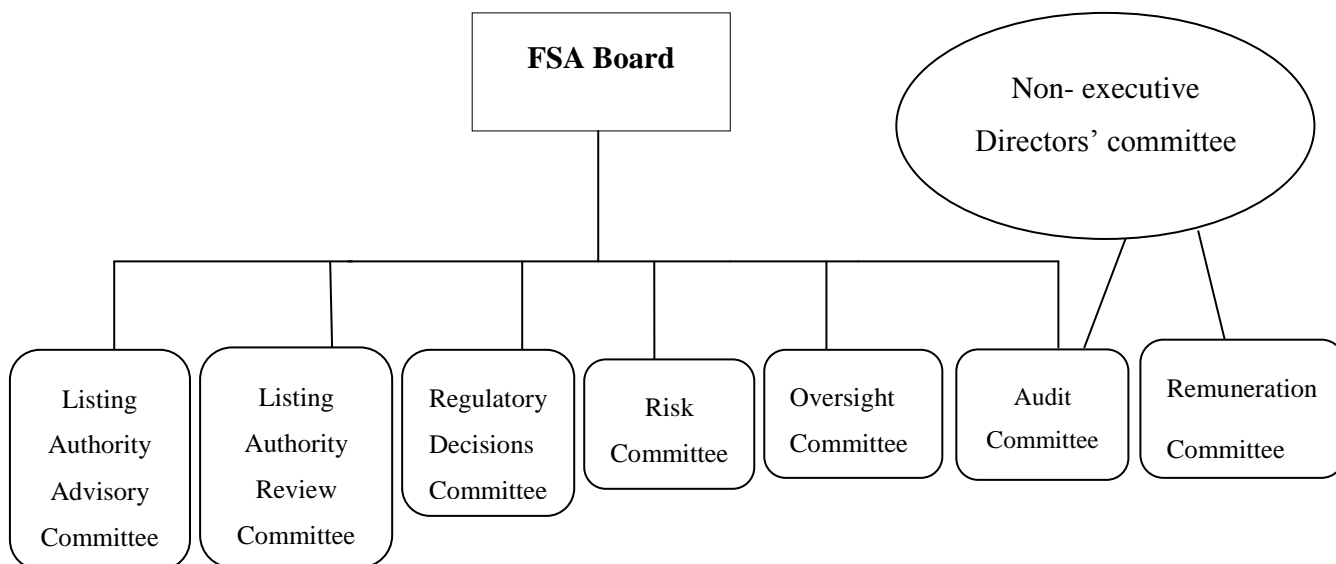
Each director had access to the advice and services of the company secretary, who also advised the Board on all aspects of governance matters. The company secretary was responsible for providing access to external professional advice for directors, if required.

Due to its statutory nature, the FSA benefited from immunity under the FSMA in respect of legal action, which it supplemented with indemnities in favour of individual directors. The Board therefore regarded insurance in respect of legal action against directors as unnecessary.

As reported last year, a number of evaluations relating to the Board, its members and committees that were started during 2011/12 were completed in the early part of 2012/13. These were facilitated by external consultants and reviewed what lessons could be learned for the remaining tenure of the FSA and for the future operation of the FCA. In view of the changes to the regulatory framework and the transition of the FSA into two new regulatory bodies, it was agreed that it would not be appropriate to carry out further reviews of the effectiveness of the Board, its members or its committees during 2012/13.

In September 2011, the Board established a sub-group to support the executive in the development of the FCA. The sub-group was initially chaired by Adair Turner as chair of the FSA and, from October 2012, by John Griffith-Jones as chair-designate of the FCA. The other members of the sub-group were all non-executive directors. The sub-group was advisory in nature and had no delegated decision-making duties or powers. It was responsible for providing support and challenge to the CEO designate of the FCA to ensure that the FCA was developed as a ‘fit for purpose’ successor to the FSA.

Governance Structure of the FSA



In October 2012 the Board also established a sub-committee to oversee the FSA's review of the failure of HBOS.

The Non-executive directors' committee (NedCo)

The functions of NedCo were set out in the provisions of Schedule 1 to the FSMA and, during the year, NedCo ensured that its statutory functions were being satisfactorily discharged by:

- reviewing reports on the efficient and economic use of the FSA's resources;
- receiving reports on the Audit Committee's (AuditCo) work in keeping under review the question of whether the internal financial controls secured the proper conduct of the FSA's financial affairs (via reports made to the Board); and
- receiving reports from the Remuneration Committee (RemCo) on the remuneration awards to the executive directors and the chairman; and the performance-related bonus payments made to the executive directors.

NedCo's composition is shown in Table 1.

Report of the non-executive directors

The Board was the FSA's primary decision-making body. It also exercised a broad oversight of all policy, strategic and operational activities. The extent of the Board's role and the information provided to it allowed NedCo to rely largely on the Board's work while sharing other functions, including oversight of internal controls, with AuditCo. RemCo reported on its work to NedCo.

Efficiency and economy

During the year, NedCo reviewed whether the FSA was using its resources in the most efficient and economic way. Data relating to measuring efficiency and economy formed part of the management information presented to the Board quarterly, and was reviewed specifically by NedCo. NedCo challenged the information it received and sought further explanations when appropriate. During the year under review, NedCo monitored the implementation of the internal twin peaks system, which separated the FSA's business into prudential and conduct divisions in preparation for legal cutover to the new regulatory framework on 1 April 2013. One impact of internal twin peaks within the Conduct Business Unit was an initial shortage of experience of managers with their firms due to the split of staff following the introduction of the internal twin peaks structure and the previous focus on prudential issues. NedCo noted, however, that this was being addressed through training to ensure that staff were appropriately skilled.

Internal financial controls

During the year, AuditCo reviewed audit progress reports from the National Audit Office and assessments from the Internal Audit Division on the relevant FSA key internal controls to obtain assurance that the internal financial controls secured the proper conduct of the organisation's financial affairs. Feedback on this work was provided to the Board.

Remuneration of the executive directors

NedCo had delegated to RemCo the function of determining the remuneration of the chair, the chief executive, the executive directors and certain other senior staff.

In addition to its statutory functions, NedCo discussed how the Board was involved in, and alerted to, issues of significant interest or issues that had significant reputational impact. This assisted in considering the design for the FCA governance structure to ensure that processes were in place to facilitate the most effective communication.

Remuneration report

This section of the remuneration report is not subject to audit

Remuneration committee (Remco)

RemCo was a committee of NedCo and was chaired by the chair of NedCo.

During the year, RemCo met formally on seven occasions, and some decisions were initially made by email and later ratified.

Remuneration strategy

The FSA's remuneration strategy was to provide a remuneration package that:

- helped to attract, retain and motivate staff;
- recognised its role and responsibilities as a public authority;
- was as competitive as possible against the appropriate market;
- encouraged and supported a culture aligned to achieving its statutory objectives;
- was fair and transparent; and
- was capable of being applied consistently across the organisation.

Remuneration policy

To achieve the remuneration strategy, the remuneration policy aimed to:

- set base salaries at, or around, the median of the relevant market competitive level;
- target reward at those whose performance was strongest;
- reward stretching performance; and
- provide an appropriate balance between the need to attract, retain and motivate staff, while reflecting the constraints placed on a public authority.

2012/13 Remuneration review

The total remuneration package, which was common to all FSA employees, comprised:

- basic pensionable salary;
- eligibility to be considered for a performance-related annual individual incentive award;
- additional flexible benefits; and
- pension contribution.

The information contained in the remuneration table has been audited by the external auditor. All individuals who held the post of executive director during the year had continuous contracts of employment providing for no more than 12 months' prior notice of termination by either party. The chair was employed on a fixed-term contract, which began on 20 September 2008 and was due to end on 19 September 2013, although, Adair Turner stepped down as chair and as a director of the organisation when the FSA ceased to exist at legal cutover.

RemCo determined the remuneration of the executive directors. To help with this, RemCo received information on, and assessment of, their individual performance. Performance was measured against the achievement of the collective FSMA objectives by reference to the Business Plan, the objectives relating to the directors' individual areas of responsibility and assessment of their leadership abilities.

In considering executive remuneration, RemCo had advice from the Director of Human Resources and market data from Towers Watson, its external consultants.

Basic personable salary

Salaries were reviewed annually in line with the policy. When making decisions on base salary, RemCo was mindful of the need for public sector organisations to continue to exercise restraint.

In considering the pay review for the year, the committee noted the importance of remuneration packages being sufficient to attract and retain staff while awarding any salary increases in a responsible manner, ensuring careful use of the FSA's resources. Some difficulties were experienced in attracting and retaining certain levels of suitably qualified professionals and, to retain the appropriate staff, it was important for the Executive to focus reward clearly on performance. This resulted in some staff receiving no pay increase, but the committee considered that the previous year's exercise, which had aimed to give the majority of staff a pay rise and also to address key anomalies, went some way to ameliorating this issue.

The Committee noted that the Executive had issued new equal pay guidelines and required clear indications of peer comparisons for all staff. The FCA Executive will look at the design of the pay bands for the new organisation and the need to ensure reward is linked to performance will continue to be emphasised.

Annual incentive award

During the period under review, the executive directors were eligible to be considered for a performance-related incentive award up to a maximum of 35% of average base pensionable salary applying during the previous year.

Last year, the organisation had an extended performance period of 15 months (1 January 2011 – 31 March 2012) to enable the performance period to align with the financial year. This was a one off transition. For 2012/13, the performance year was 1 April 2012 – 31 March 2013.

The chair was not eligible to be considered for an individual incentive award. When making its decisions, RemCo took proper account of all aspects of the FSA's and the individual's performance

Other benefits

A sum was available for each director, which could be spent against a range of benefits. The sum for the chair and executive directors is included in 'other

emoluments' in the remuneration table. The chair and executive directors also had access to a car and driver and, where appropriate, the relevant portion of these costs is included in 'other emoluments' in the remuneration table.

Pensions

The FSA Pension Plan (the Plan) has two sections, both of which are non-contributory; a defined benefits section (closed to new entrants and any future accruals) and a defined contribution section. Adair Turner and Hector Sants are not members of the Plan and were entitled to receive a non-pensionable supplement. The sums paid to the chair and each of the executive directors, in respect of each component, are shown in the remuneration table.

Remuneration Table

	Board fee	Salary	Performance related bonus	Other emoluments and benefits	Contractual entitlements on termination	Pension	2013 Total	2012 Total
	£	£	£	£	£	£	£	£
Chairman								
Adair Turner ^{1, 2, 4}	-	446,250	-	33,353	252,000	53,550	785,153	500,474
Directors								
Hector Sants ^{2, 11}	-	184,615	-	30,648	300,178	15,000	530,441	835,731
Martin Wheatley ^{2, 9}	-	429,999	86,000	112,386	-	38,700	667,085	399,657
Directors ⁵								
Amanda Davidson	35,000	-	-	-	-	-	35,000	35,000
Sandra Dawson	42,436	-	-	-	-	-	42,437	35,000
Peter Fisher ^{7, 13}	-	-	-	-	-	-	-	-
Brian Flanagan ¹²	32,083	-	-	-	-	-	32,083	35,000
Karin Forseke ¹⁰	15,462	-	-	-	-	-	15,462	57,333
John Griffith- ^{2, 3}	99,167	-	-	192	-	11,900	111,259	-
Mick McAteer	35,000	-	-	-	-	-	35,000	35,000
Brian Pomeroy ^{6, 8}	62,436	-	-	-	-	-	62,436	55,000

Andrew Scott ^{6, 13}	45,000	-	-	-	-	-	45,000	37,012
James Strachan ¹³	35,000	-	-	-	-	-	35,000	35,000
Paul Tucker ^{7, 13}	-	-	-	-	-	-	-	-
	401,584	1,060,864	86,000	176, 579	552,178	119,150	2,396,356	2,060,207
executives							1,982,679	1,735,862
Fees for service as								
Directors							413,677	324,345

Where Directors have served for part of the year only, the remuneration figures are shown as pro-rated.

1. On becoming Executive Chairman with effect from 1 July 2012, Adair Turner's salary was increased to £450,000 from £435,000
2. Adair Turner, Hector Sants, Martin Wheatley and John Griffith-Jones are not members of the FSA Pension Plan and received a non pensionable supplement in lieu of pension contributions.
3. John Griffith-Jones was appointed as a non-executive director and chairman designate of the FCA on 1 September 2012.
4. Adair Turner's total emoluments for service during the year were £533,153 (2011/12: £500,474). In addition Adair Turner received in April 2013 a payment of £252,000 as compensation for termination of employment as he was restricted in respect of taking paid employment for a period of six months from April 2013 to September 2013. Lord Turner had been employed on a fixed-term contract which was due to end on 19 September 2013 but which was terminated on 31 March 2013.
5. The fee for non-executive directors was set by the independent panel, established with the approval of HMT, at £35,000 per annum with effect from 1 April 2011. This remained unchanged in 2012/13.
6. An additional fee of £10,000 per annum is paid to any non-executive director who has been appointed to chair a committee of the Board. Andrew Scott was appointed to chair the Risk Committee from 19 January 2012. Brian Pomeroy was appointed as Audit Committee Chair with effect from 4 July 2012. Sandra Dawson was appointed as Chair of NedCo with effect from 4 July 2012.
7. Peter Fisher and Paul Tucker both waived their Board fee in respect of the years concerned.
8. Brian Pomeroy was appointed to chair the FSA Pension Plan Trustee Ltd from 1 June 2010. The annual fee was set by the independent panel at £20,000 with effect from 1 April 2008. This remained unchanged in 2012/13.
9. Martin Wheatley was appointed as an executive director from 1 September 2011 and accordingly his

remuneration for 2012 in the table above is only in respect of seven months.

10. Karin Forseke discharged the role of Chair of Nedco and Senior Independent Director from June 2010 until her resignation from the board with effect from 3 July 2012. She undertook additional work in relation to this and her appointment as Deputy Chair was formalised with effect from 1 June 2011. There was an adjustment to her fees to reflect the additional work to a total of £60,000 which comprised a non-executive director fee of £35,000, an additional fee for chairing AuditCo of £10,000, and an uplift as Deputy Chair of £15,000. The maximum amount for this position had previously been set by the independent panel at £69,000.
11. Hector Sants resigned as chief executive and as a director with effect from 30 June 2012. In line with his contractual entitlement, on leaving the FSA he continued to be employed by the FSA for a further six months during which he received his full pay and benefits and was unable to take paid employment in another organisation.
12. Brian Flanagan resigned as a director with effect from 28 February 2013.
13. Sandra Dawson, Peter Fisher, Andrew Scott and James Strachan resigned as directors with effect from 31 March 2013 and Paul Tucker also left the board with effect from 31 March 2013 when section 1A of the Financial Services and Markets Act 2000 took effect.
14. Margaret Cole resigned as a director with effect from 31 March 2012. In line with her contractual entitlement, on leaving the FSA she continued to be employed by the FSA for a further five months during which she received her full pay and benefits totalling £250,897 and was unable to take paid employment in another organisation.

Non-executive directors

It was not considered appropriate for the fees payable to the FSA's non-executive directors to be increased in the last year before the regulatory restructure and accordingly the level of fees remained unchanged during 2012/13.

The fees payable are shown in the notes to the remuneration table.

Committees of the Board

Audit committee (AuditCo)

AuditCo's purpose within the FSA was to be responsible for reviewing and providing assurance to the Board on the effectiveness of the FSA's internal controls and risk management systems, the integrity in the annual accounts of the financial statements that relate to financial controls and internal risk, and oversight of the external audit process. The review of external risks and the review of individual firms were outside the Committee's terms of reference. The former lay with RiskCo and the latter with the supervisory process.

Details of AuditCo members' attendance at meetings can be found in Table 1.

In view of the changes to the regulatory framework and the transition of the FSA into two new regulatory bodies, it was agreed that it would not be

appropriate to carry out a further review of the committee's effectiveness in the 2012/13 financial year. The operation of AuditCo was, however, reviewed with respect to the way it will operate following legal cutover and the committee's terms of reference have been amended as appropriate.

AuditCo met on six occasions during the year; in addition to the four scheduled meetings, the committee also formally met twice to consider progress on the review being undertaken by Internal Audit in relation to LIBOR. The FSA chief executive attended one of the scheduled meetings before leaving the organisation and the FCA chief executive designate attended three of the scheduled meetings. The chief operating officer, the director of internal audit and the lead audit partner from the National Audit Office (NAO) or his alternate, attended each of the scheduled meetings at the request of the committee chair. Private sessions were held with the internal and external auditors during the year without management present. The committee also held private sessions with a number of members of the senior leadership team without management present.

The committee reviewed and challenged the risk reporting proposals under the twin peaks model and expressed concern that operational problems could arise as a result of a vacuum during the transition process. Following discussion with the chief executive, however, the committee considered that the proposed way forward was sensible, but expressed concern that an FSA consolidated risk report was not available between the introduction of ITP and legal cutover.

The committee also oversaw the review by Internal Audit of the extent of awareness within the FSA of inappropriate LIBOR submissions.

To discharge its functions AuditCo carried out the following during 2012/13:

- Monitored the integrity of the financial statements and challenged management on financial performance.
- Reviewed the financial reporting judgments and disclosure issues.
- Reviewed pension plan arrangements.
- Reviewed the FSA's financial policies.
- Reviewed the chairman's expenses.
- Reviewed and challenged the identification of internal risks, including financial management risks, information systems risk and people risks (as reflected in the consolidated risk report), and managers' mitigation of these risks.
- Reviewed the operation of the FSA's whistleblowing policy and received reports on specific issues.
- Reviewed compliance by FSA staff with key internal policies and procedures, including the operation and management of the Staff Code of

Conduct.

- Reviewed potential and actual litigation against the FSA.
- Reviewed the audit universe (i.e. the internal audit framework) and approved proposals by Internal Audit for it to be more risk-focused.
- Reviewed and approved the audit plans for internal audit.
- Monitored and challenged managers on their responsiveness to internal audit findings.
- Reviewed the quarterly reports from internal audit.
- Reviewed the independence and effectiveness of the external auditor. The FSA aimed to protect the external auditor's independence through its policy, which required that fees for non-audit services were limited to the charge for performing the audit of its annual accounts. Information on fees paid to the auditor is given on page 139. Moreover, there were no relationships between the NAO or its staff and the FSA that affected the NAO's objectivity and independence.
- Considered the external auditor's audit strategy for the financial year.
- Reviewed programme and project management in the FSA.
- During the year the Audit Committee also commissioned a review of the adequacy and effectiveness of the Internal Audit function. This work was carried out by an external consultant who was specifically asked to ensure that the outputs from the review would be as useful as possible, both for the FSA and for the FCA in the new regulatory structure. The outcome of the review was very positive, noting that the Internal Audit function had strong leadership, a professional team and good execution of work. The report also made a number of recommendations meriting further consideration by the FCA Audit Committee and the FCA executive in due course.

Risk Committee (RiskCo)

RiskCo's purpose was to help the Board review external risks to its statutory objectives. It did not review internal risks, which were the responsibility of AuditCo; nor did it review individual firms.

Details of RiskCo members' attendance at meetings can be found in Table 1.

As the FSA would cease to exist following legal cutover, it was agreed that it would not be appropriate to carry out a further review of the committee's effectiveness in the 2012/13 financial year. The operation of RiskCo was, however, reviewed with respect to the way it will operate in the FCA following legal cutover and the committee's terms of reference have been amended to reflect its proposed purpose and duties as the FCA risk committee in the new regulatory framework.

RiskCo had responsibility for review and oversight of the risks to the FSA's statutory objectives, the FSA executive's appetite for such risks, and the

management and mitigation strategies and systems used to control these risks. In discharging that responsibility, RiskCo received regularly during the year, information on the top risks as articulated by both the Conduct Business Unit and Prudential Business Unit Executives. These risks were reviewed by the Executives in the respective business units, who considered appropriate mitigation strategies.

The committee sought assurance from the FSA Executive through debate and challenge in the following areas: whether the major risks to the FSA's statutory objectives and its reputation had been identified and prioritised appropriately; whether the actions taken to address and mitigate the risks were effective; and whether the timescales for mitigation were appropriate. RiskCo reported to the Board on its consideration of the risk areas and reports from the Executive.

During the year, RiskCo highlighted to the Board concerns that the move to an Internal Twin Peaks (ITP) model had led to some elements of the control framework being weakened. In particular, a separation of the way in which the FSA's risk framework was being applied in the prudential and conduct business units. On balance, RiskCo believed this development of separate risk tolerances and frameworks in the new regulators, continued macroeconomic strains and the extent of internal change to the organisation elevated substantially risks to the FSA's statutory objectives, although not necessarily to its successor organisations. RiskCo requested that the Executive of both the Conduct Business Unit and the Prudential Business Unit keep it informed of their developing new frameworks and that it be kept fully informed of issues emerging under these frameworks.

RiskCo discussed with management the amount and detail of the information provided to it, as this had reduced following the introduction of ITP. For part of the year, RiskCo considered that it did not have enough information about new approaches being used to effectively challenge the Executive or to provide assurance to the Board that risks were being measured or mitigated appropriately. When additional information was requested and provided by the Executive on the top-down and bottom-up risks, this provided reassurance that key risks had been identified even if mitigation was difficult during the period of change and transition to the new regulatory structure.

Being conscious of the risks of transition from the FSA to the FCA, RiskCo kept under review the coordination between the prudential and conduct business units of the FSA. The committee also considered a number of forward-looking risk scenarios and a diverse range of risks and mitigation strategies, including consideration of the FCA risk outlook; the development of the FCA's approach to risk and business model and strategy analysis as a tool to identify potential conduct issues.

Internal controls

The Board and NedCo (the latter under FSMA) were responsible for ensuring the FSA had a sound system of internal controls and risk management (internal risks being overseen by AuditCo and external regulatory risks by RiskCo). AuditCo reported at least quarterly to the Board on internal controls and internal risk management. AuditCo received regular reports from managers on financial, operational and compliance controls and the risk management systems. In addition it received and reviewed reports from the Director, Internal Audit summarising work undertaken, findings and actions by managers.

The system was designed to provide reasonable but not absolute assurance against material misstatement or loss and to manage rather than eliminate risks to the FSA's statutory objectives. The Board's policy on internal controls and risk management included established processes and procedures for identifying, evaluating and managing significant risks.

The internal control processes were in place throughout the year. Key features of the internal control system included the following:

- Risk reporting that highlighted the key internal and regulatory risks faced. This facilitated discussion on the best course of action to mitigate the key risks and helped senior managers make decisions on priorities and resource allocation. This was regularly reviewed by the Executive Operations Committee and the Executive Committee and formally reported to AuditCo on a quarterly basis through the consolidated risk report.
- A review of the framework of controls to mitigate the key internal (and regulatory) risks faced.
- Internal Audit's provision of independent assurance to the FSA Board and management on the effectiveness of risk management and controls over all of its activities.
- The Audit Universe, which contained all the FSA's activities, systems, projects and programmes. Each unit within the universe was assessed appropriately to prioritise review by Internal Audit and these priorities were revised periodically. Factors considered included risk, business criticality and materiality.
- The terms of reference of the Internal Audit function were reviewed during the year. As noted in AuditCo's report, a full review of the effectiveness of Internal Audit was also carried out during the year.
- Clear reporting lines and delegated authorities, which were reviewed on a regular basis.
- The external audit, including interim and final audit, which provided assurance to the Board and senior management in relation to financial controls. The independence and effectiveness of the external auditor was

reviewed by AuditCo and reported to the Board on an annual basis.

- Clear segregation of the regulatory aspects of the FSA's supervisory operations and those of the internal treasury function. In addition a third party was used to decide, from a list of approved counterparties, where best to place deposits for the optimum return. This enabled the FSA to adopt a robust 'Chinese Wall' arrangement in line with good market practice.
- Ensuring appropriate policies and procedures were contained within the staff handbook.
- The performance management framework, which included setting objectives on an annual basis and a formal appraisal process.
- Directors' and senior managers' commitment to maintaining an appropriate control culture across the FSA, which was regularly communicated to all staff.

Regulatory Decisions Committee (RDC)

The RDC decides whether the regulator should give the statutory and other notices described as within its scope by the Handbook, any regulatory guide or legislation. During the period under review, members of the RDC were appointed by the FSA Board. The FSA Board received quarterly reports from the RDC Chairman, who also attended Board meetings twice a year to discuss significant matters in those reports.

Listing Authority Committee

The Listing Authority Advisory Committee (LAAC), the membership of which comprises external practitioners, met three times during the year. The LAAC's role was to advise the Board and review elements of the FSA's function as the competent authority for listing in the UK. The chairman provided reports to the Board on relevant issues.

The Listing Authority Review Committee, whose role within the FSA was as a technical appeal committee, was not called during the year.