

**The Regulation of Insider Dealing:
An Applied and Comparative Legal Study towards Reform in
the UAE.**

Submitted by Abdulsalam Albelooshi, to the University of Exeter as a thesis for the degree of Doctor of Philosophy in Law, August 2008.

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ABSTRACT

Insider dealing on the basis of inside information has been identified as an action against the principle of equal access to information for all those who need such information to make investment decisions. This thesis examines the regulation of insider dealing in financial markets. It analyses in particular the problem of the regulation of insider dealing in the United Arab Emirates (UAE), the shortcomings of this regulation and how it can be improved. The primary objective of the thesis is to offer reasonable recommendations for the reform of insider dealing in the UAE. There have been controversies regarding whether insider dealing should be regulated, the basis of such regulation and the form in which the law should intervene. This thesis has attempted to provide its own approach to the problem of insider dealing. This approach forwards the proposition that allowing insider dealing on the basis of inside information is against the principle of equal access to information and it is detrimental to market transparency. Based on this proposition, the thesis investigates the shortcomings of the current regulation of insider dealing in the UAE. Following this the applied study, which consists of a questionnaire and interviews conducted in the UAE, provides a clearer picture of the current regulation in the country. The study aims at measuring opinions and attitudes of investors and other experts towards the basis and effectiveness of the regulation of insider dealing in local markets in the UAE. This is followed by a legal comparative study. This is both a 'macro-comparison' and a 'micro-comparison' between the regulation of insider dealing in the jurisdictions of the US, the UK and the Dubai International Financial Centre (DIFC). The 'macro-comparison' draws conclusions from comparing the broader systems of regulation in the three jurisdictions. The 'micro-comparison' concentrates on a functional comparison between the specific rules related to insider dealing. The legal comparative study is combined with the information generated by the applied study. Together these provide solutions (represented as recommendations) for the reform of the UAE larger system of regulation, and amendments to the rules related to insider dealing.

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List of Abbreviations

ADSM	- Abu Dhabi Securities Market
CBU	- Central Bank of Union (UAE)
CFTC	- Commodities Futures Trading Commission (US)
CJA 1993	- Criminal Justice Act 1993 Part V (UK)
DFM	- Dubai Financial Market
DFSA	- Dubai Financial Services Authority
DGCX	- Dubai Gold and Commodities Exchange
DIFC	- Dubai International Financial Centre
DIFX	- Dubai International Financial Exchange
DMCC	- Dubai Multi Commodities Centre
DTG	- Disclosure and Transparency Guide, FSA Handbook (UK)
DTR	- Disclosure and Transparency Rule, FSA Handbook (UK)
FCL 8(1984)	- Federal Company Law No. 8 of 1984 (UAE)
FSA 1986	- Financial Services Act 1986 (UK)
FSA	- Financial Services Authority (UK)
FSMA 2000	- Financial Services and Markets Act 2000 (UK)
IOSCO	- International Organisation of Securities Commissions
IPO	- initial public offer
NASD	- The National Association of Securities Dealers (US)
OSR	- Offered Securities Rules (OSR) (DIFC)
OTC	- Over-the-counter
RFD	- Regulation Fair Disclosure, SEC (US)
SCA	- Securities and Commodities Authority (UAE)
SEC	- Securities and Exchange Commission (US)
SIB	- Securities Investment Board (UK)
SROs	- Self Regulatory Organisations
UAE	- The United Arab Emirates

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The United States

Securities Act 1933.

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Introduction

For a thesis as an academic project, planning has a high priority. In particular, the strategy and goals in any project have to be specifically determined. The aim of this thesis is that the objectives should be achieved through answering the research questions. For this reason, it is initially necessary to determine the problems, objectives and methodology.

The subject of insider dealing is the core problem examined in this thesis. Insider dealing has been identified as an area affecting equal opportunities for investment in financial markets. It is generally accepted that insider dealing should be banned. Recent discussions show a readiness to regulate against it. Nevertheless, the form in which the law should intervene is still an area of debate. Over recent years, various methods have been employed to try and prevent this activity. The policy of regulation has been directed towards certain objectives for proposed legislation. In this regard, emphasis has been placed on different policies and forms of legal interference; for example; a criminal regime deterring the act of insider dealing, or an administrative regime empowering the regulator to face insider dealing and market abuse and enforce a disclosure system. Insider dealing as a problem has generated various legal solutions, but it seems that all forms of legal interference are needed in order to build an efficient system of regulation. A critical analysis of each form of legal interference reveals its individual shortcomings, but it has rarely been suggested that a certain form should be completely abandoned. The solution seems to be to keep all forms of legal interference and highlight areas of priority.

Policy considerations have focused on different regulations for insider dealing. The initial results of adopting different sanctions are not encouraging, but the argument remains that regulation can be applied in certain cases. The classic argument is that the immorality of the act and the harm caused to the general public are amongst the factors supporting the use of criminal sanctions. Thus, it seems to be a popular method. By enforcing criminal sanctions, for example, the goals are both deterrence and just punishment. However, there are arguments against criminal sanctions. The main one is that deterrence and punishment cannot be met due to difficulties in actual enforcement. The modern trend is towards empowering the regulator to face market-place problems, a method which is efficient in deterring insider dealing. An efficient regulator with clear regulatory priorities helps maintain a transparent market. Recent codes of conduct, disclosure requirements and civil or administrative penalties are all methods which have been used to control insider dealing.

Criminal sanctions seem to be the last and most severe course of action. Studying insider dealing regulations critically focuses attention on both its shortcomings and advantages. This helps in the further understanding of regulation and practice. Analysing the details of the long experience of those countries that first identified and faced insider dealing will add to the arguments and form part of the basis for recommendations. There are necessary lessons to be learnt by developing countries (which are in a race against time to make progress) from the experience of developed countries. However, the regulations should be perceived not as a problem in itself, but rather as a response to a problem. In other words, understanding the problem of insider dealing and the policy of its regulation is the first step in discussing the law of insider dealing.

In the UAE, at a time when great attention is being directed on the economy of the country and on developing related laws and regulation, it seems prudent to direct academic efforts to the same areas. In doing so, this thesis will endeavour to investigate the problem of the regulation of insider dealing in the UAE, the shortcomings of this regulation and how it can be improved. In addition to examining the immense body of thought in the area of insider dealing, we will forward a contribution of our own on the subject. Insider dealing has been an area of interest for researchers for many years. Examining this area through a thesis, with the added dimension of the UAE, will be a valuable input to the current debate. In its structure and plan, this thesis will endeavour to be original and insightful. Insider dealing is a problematic legal area and consequently it has attracted the attention of jurists who have tried to propose different solutions to meet the needs of complex regulatory requirements. This has led to the problem that insider dealing stimulates different views. A combination of both applied and legal comparative methodologies in this subject will therefore provide a useful resource for the legal profession, and in particular the legal profession in the UAE and those connected to it. As far as I am aware, this will be the first such research focusing on the UAE. It will add value to make reasonable recommendations which can be sent to the agencies specializing in the regulation of the financial markets of the country.

The objective of the thesis should be clearly determined. Consideration of the fact that there is already a considerable body of academic work in the subject suggests that the thesis has to be directed to a certain objective which promises an original contribution. In broad terms, the aim of the thesis is to develop a holistic understanding of the regulation of insider dealing in financial markets. Nevertheless, the ultimate objective of the thesis is to reach reasonable recommendations for reform of insider dealing regulation in the UAE. It

may be expedient to state that the objective of this thesis can be achieved through achieving the following subsidiary steps:

- Examining the extent and nature of insider dealing in real life in the UAE financial markets.
- Exploring what its effects on the financial markets are.
- Considering the shortcomings of the current rules directed to regulating insider dealing.
- Looking at the way in which the law and regulation can be improved to prohibit insider dealing.
- Answering whether the rules of the Dubai International Financial Centre are a good example of reform in local market regulation.
- Learning lessons from the experiences of developed countries in the area, in particular the UK and the US.
- Investigating the meaning of ‘insider’ and ‘inside information.
- Determining how to empower the regulators to enforce the rules.
- Working out what sort of punishment is appropriate to deter insider dealing.
- Determining what the relationship is between the rules directed to prohibit insider dealing and those directed to timely disclosure.
- Seeing how insider dealing can be kept to minimum by improving the rules of disclosure.

An essential element of the plan is its **research methodology**. In this thesis, this is specially designed to be an appropriate vehicle for attaining the planned objectives. The research methodology is a combination of applied social study and comparative law methods.

One of the research methods used in this thesis will be the comparative law approach. Studying different legal systems requires comparing the ways in which each system provides a solution to the legal problem at hand. The results of this comparison will be used as recommendations for UAE law. The comparative law method of the study can be split into two sections, corresponding to the nature of legal studies. Firstly, a literature review is used as the main method of collating information. This will be effected by examining academic resources from the comparative jurisdictions, and using them in support of the arguments in the study. Secondly, as this area of law is continuously changing, there will be

a need to scrutinize all new drafts, statutes and proposals, and even news from enforcement agencies.

Setting the objective of the thesis as one of looking at the problem of insider dealing in the UAE, we aim to contribute to the body of academic thought in the area. Such a contribution seems to be appropriate to the UAE, where the law lacks sufficient academic input, especially in the area of insider dealing. Thus, the method of applied study seems appropriate for collecting more information concerning the UAE law to sustain the arguments of this study. It is felt that the combination of the two methods is the best way of achieving the objectives of this thesis.

It should be made clear that in law we have a distinct concept of research methodology. There is a distinct legal methodology for solving legal problems. A mere legal discussion of a problem involves, for instance, interpretation, case law and comparison. The difficult task is in attempting to combine social science research methodology with legal methodology to construct a comprehensive thesis. It is true that socio-legal thought has developed considerably in recent years, but legal thought still uses a unique research methodology in argumentation. In this thesis, the researcher will attempt to combine legal methodology (which is comparative law methodology) with applied social science methodology. The applied social science methodology will be discussed in the chapter which deals with applied study, while the comparative law methodology will be discussed in the chapter which addresses the comparative regulation of insider dealing.

The structure of the thesis is rationally designed to represent the problem, the methodology and the objective. The thesis commences with a literature review which examines theories concerning the regulation of insider dealing. This is important for introducing the premises of the study. The specificities of the problem and the law of insider dealing regulation in the UAE will then be identified. The situation in the UAE is then investigated in more depth through the applied study. This provides for identification of the dimensions of the problem of insider dealing in the UAE from investors' and experts' points of view. The applied study aims at supplying a reality perception of the problem. If the issue is accurately diagnosed by the applied study, it can be discussed with insight. This is followed by the second method in the thesis which is an examination of the comparative regulation of insider dealing. The comparison is a device for providing solutions to the problems raised by the applied study. The jurisdictions chosen for comparison are those of the US, the UK and the Dubai International Financial Centre

(DIFC). The comparative study is divided into two main chapters. The first looks at the background of comparative jurisdictions to gain an understanding of the wider picture of the regulation. The second comparative chapter provides a detailed functional comparison of the rules directed at insider dealing in the three jurisdictions. The structure of the study reaches a peak by introducing recommendations for reform of the law and system in the UAE. In the light of this vision, the chapters constituting the thesis are as follows:

Chapter 1: the problem of insider dealing and the policy of its regulation.

Chapter 2: the problem and law of insider dealing in the UAE.

Chapter 3: applied study: opinions and attitudes of investors and other experts towards the regulation of insider dealing in the local markets in the UAE.

Chapter 4: comparative regulation of insider dealing.

Chapter 5: functional comparison of the regulation of insider dealing.

Chapter 6: recommendations.

Conclusion.

Chapter 1: the problem of insider dealing and the policy of its regulation

Introduction

Part 1 Should insider dealing be regulated at all?

The evolution of the debate

Fairness and the ethics of insider dealing

Insider dealing as entrepreneurial compensation

The effect of insider dealing on transparency, informativeness and efficiency of the market

Economic arguments for and against the regulation insider dealing

Protection of investors and confidence in the market

International regulatory standards

Part 2 Legal theories in regulating insider dealing

Market regulation of insider dealing

Examples of policies of regulation

Conclusion

Introduction

This chapter aims to provide a literature review. Specifically, it aims to discuss critically the theories concerning the problem of insider dealing and the policy regarding its regulation. Much of the academic literature has concentrated on the debate as to whether insider dealing should be regulated or not, and the debate has centred on the justifications which underlie regulation. Such justifications vary from legal grounds to ethical and economic considerations. By reviewing the theoretical background the aim is to identify the most appropriate theoretical approach to the subject of the regulation of insider dealing. The theoretical background is considered the dominant factor in understanding this subject. The chapter is divided into two parts. The first part contains a critical examination of the different grounds used to justify regulating insider dealing. These are: fairness and the ethics of insider dealing; economic arguments for and against the regulation; the protection of investors and confidence in the market; and international regulatory standards as justification for regulation.

The second part of the chapter introduces a discussion on how the legal theories have been used to justify regulating insider dealing in both common law and UAE law. This part provides a critical discussion of the competence of general legal rules to provide a ground for regulating insider dealing. It introduces a comparative discussion between common law and UAE law in regard to three main legal grounds. These are: 'fiduciary duties', 'misappropriation' and 'misrepresentation'. This part concludes by showing the shortcomings of the general legal rules.

One argument forwarded is that insider dealing is largely a financial market problem and should be regulated in the market place. My view, which will be supported throughout the discussion, is that insider dealing is largely a financial market problem. This is apparent in the justifications underlying the regulation, especially economic arguments for regulation protection of market efficiency and protection of investors. The chapter also argues that, since general legal rules are not competent to solve the problem on their own, the best solution to insider dealing is regulation.

The policy of regulation is considered the dominant factor in any legal examination of insider dealing. Clarifying the underlying policy justifications stimulates other related questions, especially the debate as to whether or not regulation of insider dealing is justified and required. In discussing the policy of regulation it should be observed that such a policy

has been influential in forging the law and regulation of insider dealing. The chapter concludes by showing some examples how policies and justifications of the regulation of insider dealing may differ from one jurisdiction to another.

Part 1 Should insider dealing be regulated at all?

Any literature review should concentrate on the core academic contributions made in the area of the regulation of insider dealing. Specifically, the theories about insider dealing are directed to the academic debate about whether insider dealing should be regulated or not.

The evolution of the debate

It appears that the debate as to whether insider dealing should be regulated was generated by two important events. First, the use of the ‘fairness’ concept to justify the regulation in the US by the Securities and Exchange Commission (SEC) and the courts. Second, Professor Manne’s book *Insider Trading and the Stock Exchange*,¹ which is given credit for stimulating the debate regarding the ethics and economics of insider dealing.

The debate was stimulated by the first SEC and court’s decisions in the US prohibiting insider dealing. In the case of *In re Cady Roberts & Co.*² the SEC based its decision to prohibit insider dealing on grounds of ‘fairness’. This is apparent in the SEC’s wording “...special obligation has been traditionally required of corporate insiders... Analytically, the obligation rests on two principal elements; first, the existence of a relationship giving access, directly or indirectly, to information intended to be available only for a corporate purpose and not for the personal benefit of anyone, and second, **the inherent unfairness involved where a party takes advantage of such information knowing it is unavailable to those with whom he is dealing**”.³ (My emphasis)

In the case of *SEC v. Texas Gulf Sulphur Co.* the court also based its decision to prohibit insider dealing on grounds of ‘fairness’. This is apparent in the court’s wording “...to prevent inequitable and unfair practices and to insure fairness in securities transactions generally, whether conducted face-to-face, over the counter, or on exchanges ...the Rule [meaning Rule 10b-5] is based in policy on the justifiable expectation of the securities

¹ HENRY MANNE *Insider Trading and the Stock Market* (The Free Press, 1966).

² *In re Cady Roberts & Co.* 40 SEC 907 (1961). This case is explained below under heading: The ‘disclose or abstain rule’.

³ *In re Cady Roberts & Co.* 40 SEC 907 (1961). p.912.

marketplace that all investors trading on impersonal exchanges have relatively equal access to material information”.⁴

From the above-mentioned cases it is apparent that there has been support for the legal norms to regulate insider dealing. One of the most important logical premises used was that insider dealing is unfair. This assertion on legal thought techniques could be questioned, because lawyers utilize legal techniques to address problems like insider dealing. These techniques are not in themselves justification for regulating insider dealing, at least from a non-legal point of view. It is also necessary to work from convincing arguments when legislation is adopted to regulate insider dealing, and this is the case in most of the jurisdictions introducing such regulation. In other words, the problem is whether there is any principle underlying the justification for regulating insider dealing.

Professor Manne, the leading defendant of insider dealing, argued that insider dealing should not be regulated at all and criticised the legal theory grounds for regulating insider dealing as being hypocritical and self-righteous. He argues that there has been no careful analysis of the subject. Lawyers only depend on the meaning of words, previous decisions and other legal techniques. He believes that in the absence of a sufficient economic analysis, the attitude of the debate turns to moralistic and emotional issues instead of ones of logic.⁵ To counter the criticisms of Professor Manne, there should be careful consideration of other disciplinary thoughts. In specific terms, there have been two main non-legal approaches to the regulation of insider dealing: namely the ethics and the economics of insider dealing.

Therefore, we will discuss the wider issues of the ethics and economics of insider dealing first. Then, we will turn to legal theories to see the legal techniques in regulating insider dealing.

Fairness and the ethics of insider dealing

As was indicated above, the first judicial precedents to prohibit insider dealing were based on the grounds of ‘fairness’ and ‘equality of access to information’. The ‘disclose or abstain’ rule which was adopted in the cases of *Cady* and *Texas Gulf Sulphur*. This rule was based on the rationale that there is inherent unfairness when one party takes advantage of information which is not available to the other party and that all investors in a market

⁴ *SEC v. Texas Gulf Sulphur Co.*, 401 F.2d 833 (2d Cir. 1968), cert. denied, 394 U.S. 976 (1969). at 848.

⁵ HENRY MANNE ‘In Defence of Insider Trading’ (1966) 44 *Harvard Business Review* 113. p.113.

should have relatively equal access to material information. Thus, according to this view, the regulation of insider dealing is largely based on the premise that “insider dealing is unfair”. In order to maintain fair transactions, parties to a market contract or investors in the market should have equal access to information. Since insider dealing contradicts equal access to information, it is considered to offend the notion of fairness. ‘Fairness’ as a concept has been resorted to as a justification for regulating insider dealing. The general public feels that insider dealing is immoral and unfair. There is strong public feeling on the issue, although such feelings can be questionable because public thinking about what insider dealing really means is inaccurate and mixed with other feelings. Thus, although regulators and legislatures cannot disregard the strength of public opinion, it is not wise to depend primarily on it in regulating insider dealing. One of the indications that public opinion is not a sufficient justification is that outsiders to the business usually hold stronger feelings about the unfairness of insider dealing than others. This may indicate that public attitude to insiders is mixed with jealousy. It could be argued that outsiders’ strong feelings are not due to insiders making profits, but rather they object to insiders’ taking advantage of the position which they have been given compared to the general positions of other investors.⁶

Many lawyers do base their judgment that insider dealing should be regulated on the principle of ‘fairness’. One of the main advocates of this view is Schotland.⁷ Fairness is a legal concept, which is used by legal theorists in a more sophisticated way than the public thinks. Lawyers urge for equal positions in bargaining. The legal philosophy of fairness considers it unfair when insiders have an advantage and a better bargaining position than outsiders because of their access to non-public information. On this line of reasoning, probably the most viable justification underlying the regulation of insider dealing is ‘equality of information’. This attempts to justify the regulation of insider dealing on the basis that there should be ‘equality of information’ for all the parties to a transaction or all dealers in the market. Information as to the basis of decisions made by investors should be equally available to all investors. Thus, all traders owe a duty to the market either to disclose or abstain from dealing based on non-public corporate information. This approach is compatible with the need to make public as much information as possible so investors

⁶ B. RIDER and H.L Ffrench *The Regulation of Insider Trading* (London: Macmillan, 1979). pp. 1-2.

⁷ ROY A. SCHOTLAND ‘Unsafe at Any Price: A Reply to Manne, Insider Trading and the Stock Market’ (1967) *53 Virginia Law Review* 1425.

will be equally informed. One of the main functions of financial markets is to disseminate information. It is particularly the nature of financial markets which makes information disclosure crucial for investors. Allowing insider dealing contradicts the ethos of equality of information and the duty to disclose information to the market. Improper delay of disclosure would be more likely if insider dealing was allowed. Thus, as timely disclosure is an objective for market regulation, any incentives for disclosure delay should be outlawed.⁸

Equality of information as an approach to regulating insider dealing has attracted its share of criticism. Professor Henry Manne,⁹ in his criticism of the ethics of insider dealing, challenged the opinion that the practice is unfair by describing it as “an anonymous lady law student who in a classroom discussion of the subject, stamped her foot and angrily claimed, ‘I don’t care: it’s just not right’”.¹⁰ In this scientifically unacceptable example, Manne tried to argue against the ethics of insider dealing. He thinks that fairness is a respected concept, but is difficult to determine. He thinks that fairness is a vague term which cannot even be defined, let alone be used as an argument for regulation. However, those who think that insider dealing is unfair reject these contentions. They think that Professor Manne ignore the fact that that ‘fairness’ is the dominant premise underlying our understanding of the law. It is natural common sense that determines that a trustee benefiting from the trust is ‘unfair’; also, that a party’s making misrepresentation to the other party in a transaction is ‘unfair’. It is also common-sense that not disclosing material information is ‘unfair’. The contention that our sense of fairness is ‘vague’ (and this is probably the case with any concept) does not mean that we misinterpret what is ‘fair’ and what is ‘unfair’ in, for instance, a contractual relationship.¹¹

Although fairness appears to be an issue of common-sense in discussions of the law, there should be careful discussion of Professor Manne’s arguments. In challenging the ground of fairness in regulating insider dealing he depended on two grounds which seem to counter the assertions on fairness:

The first ground of Professor Manne’s criticism is that the inequality in bargaining positions between the parties in a share transaction or between investors in the market is an

⁸ ROY A. SCHOTLAND ‘Unsafe at Any Price: A Reply to Manne, Insider Trading and the Stock Market’ (1967) 53 *Virginia Law Review* 1425. p.1448.

⁹ HENRY MANNE *Insider Trading and the Stock Market* (The Free Press, 1966).

¹⁰ *ibid.*, p.14.

¹¹ See KIM LANE SCHEPPELE “‘It’s Just Not Right’: The Ethics of Insider Trading’ (1993) 56 *Law and Contemporary Problems* 123. pp.125, 151.

inevitable fact. He sees that no law or regulation can ensure equality of bargaining position. Manne sees that there is always inequality in terms of information between the parties in share transactions. The stock market, according to him, is an information exchange: “The different amount of profit and different individuals will reflect their different degrees of sophistication and the reliability of their information. The stock market is, par excellence, the arbitrator of the value of the information”¹². Hetherington, who is an advocate of this view, also argues that there is always unevenness of ‘strength’ between the parties in a share transaction. It is normal that one party has more knowledge than another. He maintains that there is no ‘insurer’ against the inequality of information between the parties in a share transaction.¹³

This argument of Manne can also be refuted on a sound logical ground. The contention that there is inevitable inequality between the parties of a share transaction does not justify why one party cannot have access to the information that the other party has.¹⁴ It is correct to say that there are uncertainties in maintaining equality, especially in opportunities in financial markets. However, this argument is not to assert that complete equality should be reached. It is rather to not allow a corporate official to take advantage of his position for his own gain. Thus, to be more accurate, the demand is for ‘equal access to information’, which does not necessarily mean that parties to a securities transaction should have ‘equal information’. If we advocate the ‘equality of information’ approach, it does not mean that we demand the unattainable proposition that the parties to a transaction should have ‘equal information’. A theory of equal access to information is to protect disadvantaged parties in financial markets or to a contract.¹⁵ Fairness, in this sense, is said to be required in equality of bargaining positions; though there are areas of inequality which cannot properly be maintained by legal intervention.

The second ground of Professor Manne’s criticism of fairness is that insider dealing is not made at the expense of anyone and there is no proof that insider dealing causes any harm. This argument has been put forward as, “insider dealing is a victimless crime”. It is wrong to assume that persons who deal with insiders before disclosure of important information would not have dealt if the insiders were not another party. In anonymous market dealings,

¹² HENRY MANNE *Insider Trading and the Stock Market* (The Free Press, 1966). p.47.

¹³ J.A.C. HETHERINGTON ‘Insider Trading and the Logic of the Law’ (1967) 4 *Wisconsin Law Review* 720.

¹⁴ B. RIDER and H.L. FRENCH ‘Should Insider Trading be Regulated? Some Initial Considerations’ (1978) *SALJ* 79. p.84.

¹⁵ KIM LANE SCHEPPE “‘It’s Just Not Right’: The Ethics of Insider Trading’ (1993) 56 *Law and Contemporary Problems* 123. p.125.

the insider deals with a person as a result of the random matching of orders. This person would have dealt anyway at the same market price at the same moment in time. This reflects that the other party to insider dealing is not misled or harmed by the insider and there is no unfairness to him.¹⁶

Manne thinks that insider dealing constitutes a very small proportion of active securities trading. There is almost no influence from insider dealing on the market price of actively traded stocks. Manne distinguishes between two groups of outsiders: short-term traders who trade in response to price changes, and long-term investors who do not trade because of short-term fluctuations in prices. He argues that regulating insider dealing is to protect only short-term speculators, rather than long-term investors. When there are insiders in the market with good news they represent a higher demand, so on the other hand there are sellers who are induced by the high demand from insiders. Manne states that the identity of the sellers and the nature of their decision-making are important factors when we analyse whether the benefits from insiders are made at the expense of the sellers. Sellers who would not trade but for the insiders' activities are those 'short-term' traders or 'speculators'. They are more likely to buy or sell depending on recent changes in securities prices. In this group, the shareholders who do not deal at all are not harmed by the insider. Rather, they benefit from the increase in market value if they hold their shares. Insider dealing results in a gradual increase in the market prices of securities in a way which reflects the correct value of the security. The result of this is to reduce the average loss and therefore the group of selling shareholders would benefit. The second group of 'investors' depends on 'fundamental' factors to select stocks, and they do not usually buy or sell because of short-term fluctuations in securities prices. An investor selling for personal reasons would most probably do so even if there was a potential rise in market prices. Moreover, insider dealing arguably benefits such a seller by increasing the market price of the share.¹⁷ The same view is adopted by Hetherington,¹⁸ who thinks that there are certain situations in which an outsider may be harmed. The first is where he dealt as a response to the price change and he sold at a time when the market price was lower than it would have been were the information disclosed. Suppose that an outsider sold his securities, induced by the activities of the insider, when the market price was £10. Following this, the price rose to £15. It can

¹⁶ HENRY MANNE *Insider Trading and the Stock Market* (The Free Press, 1966). pp.98-101.

¹⁷ HENRY MANNE 'In Defence of Insider Trading' (1966) 44 *Harvard Business Review* 113. p.114.

¹⁸ J.A.C. HETHERINGTON 'Insider Trading and the Logic of the Law' (1967) 4 *Wisconsin Law Review* 720. p.723.

be said that the insider caused the outsider's loss of profit of £5. The second situation is where the outsider would not have sold if he/she had access to the information that the insider possessed. Hetherington thinks that the situations in which the outsider loses because of the insider dealing are 'absolute odds'. He thinks the chances that the outsider has lost because of the insider's activities are 'improbable' and not worth any serious concern.

Manne and Hetherington's contentions in this regard can be answered in more than one way. They do not pay attention to the situation where the insider deals while in possession of negative information. In random market dealing it can be expected that the investor would already trade at the market price with any other anonymous party. However, where the insider deals while in possession of negative information, it cannot be said that only the short-term speculator is hurt. In fact, he is likely to suffer least if he deals at an early stage of the gradual negative change in the stock price. Thus, the question remains: is it fair to allow an insider to pass his loss to another, or even to take advantage of non-public information for personal gain?¹⁹

There is one more response which renders Manne's and Hetherington's arguments weak. It is wrong to simplify the matter and distinguish traders by two types: short-term and long-term. There are rather more sophisticated traders, the so-called 'information traders'. This group of traders constitutes investment analysts who are employed by banks and brokers, and other investors such as fund managers who are more sophisticated than the average individual investor. This group is considered the most important category of traders, since they employ their expertise and depend on the disclosed information to lead the trade. If insider dealing is allowed, it is expected that 'information traders' will lose to insiders, since they do not have the same access to information as insiders. Allowing insider dealing would benefit insiders at the expense of 'information traders' who employ their expertise and their research efforts to discover the correct price. The result would be that 'information traders' would hold back from the market, resulting in negative effects on market efficiency.²⁰

All things considered, Manne's and Hetherington's hypotheses seem to be rather weak and to simplistic. It is difficult to say that investors can be distinguished into two classes and

¹⁹ B. RIDER and H.L. French *The Regulation of Insider Trading* (London: Macmillan, 1979). p.3.

²⁰ Z. GOSHEN AND G. PARCHOMOVSKY 'On Insider Trading, Markets, and "Negative" Property Rights in Information' (2001) 87 *Virginia Law Review* 1229. pp.1242-3.

that the decision of each class is predictable. In fact, if the price rose because of insider dealing, a number of investors would sell their securities while other investors might decide to anticipate for a further increase. It is not accurate to say that only short-term traders react to the price change. Long-term traders, such as fund managers and sophisticated investors, also monitor any changes in the price of securities. It does not seem proper to argue that a certain group of investors would be harmed because they act in a certain way.

Having introduced more than one ground on which Manne's arguments can be refuted does not mean that his theory is rendered completely unsound. The difficulty with the 'fairness' principle remains whether it is the harm done, rather than only the taking of advantage of inside information, which makes the conduct unfair. The difficulty in the 'fairness' argument remains that it is hard to rationalize insider dealing regulation on the grounds of the harm done to the shareholder or the person with whom the insider randomly deals. Moreover, it is difficult to identify the harm done to other institutions, such as issuers to which the inside information relates or to the market in which the insider deals.

Depending on 'fairness' has to be rationalised on practical grounds. One of these is the harm caused by it. However, empirically addressing the harm caused by insider dealing is thought to be difficult, because insider dealing as sophisticated financial conduct is difficult to detect. The 'dark figure' containing the nature and number of real incidents is thought to be high. Despite the enhancement in regulation and enforcement, detected incidents do not apparently represent the real problem; they seem to be the tip of the iceberg. There are likely to be shortcomings in any attempt to identify and measure the problem empirically.

There have been attempts to address the harm caused by insider dealing. It has been claimed that the practice affects the interests of the corporate issuer when its shares are subjected to insider dealing. The perceived harm could be greater to the management of a company, where the person who manipulates inside information is at the same time a director, officer or even an employee. In such a situation the very confidence in the management of the company may be questioned. The integrity of a company may be shaken when it is assumed to be an 'insiders' company and this leads to instability and difficulties in securing finance. As a consequence of questioning the confidence and integrity of the management, the harm could extend to the value of shares of the company in the market. Regulating insider dealing also prevents the delay or manipulation of inside information by those who are supposed to disclose such price-sensitive information. Permitting insider dealing will confuse those whose duty it is to disclose information. It

would also have an adverse impact on the internal decision-making and efficiency.²¹ According to this view, the harm done to the issuer is the basis of legal liability for insider dealing. Nevertheless, their arguments appear to be rather insignificant. If insider dealing had negative effects on the reputation of the corporation (and this is probable) the solution would be an internal penalty on the insider. Inside information could emerge outside the corporation, as is the case in takeover bids. In such cases, if an ‘outsider’ uses the inside information related to the corporation it is not likely that his act is detrimental to the reputation of the corporation or to its internal efficiency.

Although it is argued as vague, ‘fairness’ as a concept would lead us to the conclusion that it is unfair when the insider deals while privileged by information acquired by virtue of his position or a relationship. One important response to Manne’s arguments is that the ‘fairness’ principle should not be narrowly interpreted as equivalent to the protection of investors. It is maintained that ‘fairness’ as a principle is equivalent to a public policy. That is, the concept of fairness can be depended on even if there is no actual harm to the particular investor. If it is expected that insider dealing will be harmful, not necessarily to a particular investor but rather to the market as a whole, for reasons of public policy, such acts should be regulated. This was apparent in the views of a writer who made his point in the same year Manne put forward his ideas. He said: “If the action of the insider is declared unlawful it does not follow that the conduct should remain unpunished merely because the particular investor dealing with the insider is not prejudiced. Sanctions such as criminal penalties or a civil liability could be imposed”²².

Insider dealing as entrepreneurial compensation

Manne maintains that his main argument is not the price effect of insider dealing. He claims that the main argument is that allowing insider dealing is the only effective means of compensating entrepreneurs.²³ He distinguished between corporate managers and entrepreneurs. Managers’ tasks, he thinks, do not include innovations. Their work is a mere service which includes operating the firm normally. Since their work is predictable, a salary can be sufficient compensation. Manne thinks that entrepreneurs’ work includes innovations. They provide innovative contributions to the productivity of the firm. Their

²¹ ROBERT J. HAFT ‘The Effect of Insider Trading Rules on the Internal Efficiency of the Large Corporation’ (1982) 80 *Michigan Law Review* 1051. p.1071.

²² B. A. GOODMAN ‘Insider Trading Without Disclosure-Theory of Liability’ (1965) 28 *Ohio State Law Journal* 472. p.476.

²³ HENRY MANNE *Insider Trading and the Stock Market* (The Free Press, 1966). pp.110-6.

tasks result in producing valuable information for the firm. Manne argues that allowing insider dealing is the only appropriate means of compensating entrepreneurs so that they will be given an incentive to produce more information. A predetermined salary may not reflect the service provided by the entrepreneur, since it does not reflect the value of the innovation. Manne argues that only allowing entrepreneurs to buy securities prior to a public disclosure, and to sell them after the price rises following the disclosure, is the appropriate method to value his innovation.²⁴

Carlton and Fischel²⁵ advocate the same view. They argue that advanced salary agreements fail to compensate for innovations. Allowing insider dealing enables agents to receive their compensation. Insider dealing provides more accurate valuing of agents' innovations than a salary. It is argued, therefore, that more incentives should be provided for agents to produce information.

Manne pointed out that his main argument is that allowing insider dealing is the only effective means of compensating entrepreneurs. It is surprising that Manne concentrated on what seems the weaker component of his theory. There are several grounds on which Manne's argument can be refuted. The most important appears to be that he ignored the property right of the firm to the information. A firm's property right to information is based on the same principle as that which asserts that a company can own intangibles such as trade marks and commercial secrets. If it is established that a firm has a property right to the information produced inside the firm, or at least that the insider is entrusted not to use such information, then it is wrong to propose that the use of such information should be allowed as the only appropriate means of compensation. The firm's property right to the information is the premise on which the 'misappropriation theory' in the US is based.²⁶

Schotland²⁷ also rejects Manne's argument on more than one ground. He thinks that the company can assess its managers and employees. A company can evaluate the tasks are required from an employee and provide an appropriate salary for his/her work. A company is best placed to evaluate whether or not an employee is expected to provide innovative ideas. Schotland also thinks that insider dealing is not necessarily a better compensation

²⁴ HENRY MANNE *Insider Trading and the Stock Market* (The Free Press, 1966). pp.116-9.

²⁵ CARLTON, DENNIS W. AND FISCHEL, DANIEL R. 'The Regulation of Insider Trading' (1983) 35 *Stanford Law Review* 857. pp. 869-871.

²⁶ 'Misappropriation theory' is explained below under the heading: 'Misappropriation' theory.

See BAINBRIDGE, STEPHEN 'Insider Trading' in *Encyclopedia of Law and Economics III* (Edward Elgar Publishing, Cheltenham, U.K.,2000). pp.781, 791-4.

²⁷ ROY A. SCHOTLAND 'Unsafe at Any Price: A Reply to Manne, Insider Trading and the Stock Market' (1967) 53 *Virginia Law Review* 1425.

than a salary. Even if the insider is allowed to use inside information, the compensation he receives will be limited to the wealth he has. An insider may also have limited experience in the position of the company and the stock market. Allowing him to deal on the basis of inside information is not necessarily a better compensation than other guaranteed compensations such as salaries and commissions. Schotland also thinks that it is difficult to restrict trading to those who produce the information. Other agents and employees may deal on the basis of inside information without having provided any innovative services.

Another criticism to Manne's thesis produced by Rider and Ffrench is that he does not explain why insiders should be permitted to benefit from producing negative news. Allowing insiders to deal on the basis of negative inside information allows them to evade losses whether the company succeeds or not. If a manager was behind a loss to the company, why should he be able to avoid a personal loss by allowing him to sell his securities before the information is made public?²⁸

The effect of insider dealing on transparency, informativeness and efficiency of the market

Probably the most important area of the debate about regulating insider dealing is the inquiry into the effect of insider dealing on the market. If it is thought that insider dealing has effects on the transparency and efficiency of the market, then it should be regarded as a public policy to regulate it. However, there is an academic debate regarding the effects of insider dealing on the market. Advanced attempts to analyse the effects of insider dealing on financial markets have been made by economists. Economic theories depend on the concept of the importance of information to the market. In order to understand the importance of information in the marketplace, it is vital to indicate the role of financial markets and the mechanism through which they work. Therefore, before discussing the effects of insider dealing on the market there should be a short introduction.

The role of financial markets is primarily to allocate resources to those corporations which offer the best investment opportunities. Financial markets are known as an important method for a country to drive its economy and accelerate economic growth. One of its important roles is to operate as an intermediary for both the private and public sector entities to raise capital and finance productive projects. Financial markets are expected to be an efficient method for private sector expansion and public sector infrastructural

²⁸ B. RIDER and H. L. Ffrench 'Should Insider Trading be Regulated? Some Initial Considerations' (1978) *SALJ* 79. p.90.

development. Simplifying it, the main role of financial markets is to act as an intermediary to improve the allocation of resources in the most productive economic projects. In fact, financial markets are essential as intermediaries, since they play an important role in the optimal allocation of resources. This has its important impact on macroeconomics, for even if a country has savings its growth can be underdeveloped if its financial system fails to allocate these savings where they can have the optimal impact on the economy.²⁹

Stephens and Beck-Dudley introduced an important thesis in the area of the relationship between insider dealing and the Efficient Market Theory.³⁰ They explained the importance of financial markets and the role of information in such markets. One important classification of financial markets is the ‘primary market and secondary market’. In brief, the difference is that primary markets facilitate the issue of new securities, the so called Initial Public Offering (IPO) while secondary markets allow for dealing in existing securities. The primary market allows financing new corporations and projects which would otherwise be costly if financed by creditors such as banks. On the other hand, one of the main characteristics of the secondary market is ‘liquidity’, which gives the investors the opportunity to turn their securities back into cash: ‘to liquidize securities’. If ‘liquidity’ were not possible, investors would be uninterested in buying securities; this may be true even in primary markets. Thus, a secondary market has a complementary role in attracting investors to participate in business by dealing in securities. Such investments are attracted by the special characteristics of the secondary market. One important quality of a secondary market should be its ability to allow investors to observe the value of securities. This could be achieved through the economic powers of investors’ supply and demand, which move the price of the securities. In this respect, investors depend on information (either related to the issuer or observed from market information) to make decisions to buy or sell. Consequently, another important quality of a secondary market is the presence of sufficient ‘liquidity’, which is a main element in an active market. Investors are also attracted by the ‘liquidity’ possibility, which entices them to purchase and sell securities.³¹

The secondary securities market, its role in allocating resources and its systematic nature in assessing the value of securities, are all important for the economy. Informed prices of

²⁹ RENÉ STULZ ‘Does Financial Structure Matters for Economic Growth? A Corporate Finance Perspective’ in ASLI DEMIRGÜÇ-KUNT AND ROSS LEVINE (eds.) *Financial Structure and Economic Growth: a Cross-Country Comparison of Banks, Markets, and Development* (Cambridge; Mass.; London: MIT, 2004). p.143.

³⁰ ALAN A. STEPHENS AND CARYN L. BECK-DUDLEY ‘The Efficient Market Theory and Insider Trading: Are We Ahead in the Right Direction?’ (1989) *27 American Business Law Journal* 441.

³¹ *ibid.*, p.449.

securities benefit the economy, whereas prices which do not reflect market information may lead to incorrect value. The consequence of this is direct dealing in false prices. The decisions made by investors are important because they affect the allocation of financial resources to better investments, which in turn raises the growth rate of the economy and vice versa. Dysfunction may lead to a misallocation of resources, sending wrong signals to the rest of the economy and causing over-investment in a negative way in the macroeconomics.³²

It is this point which requires financial markets to be efficient. Where financial markets are efficient the prices reflect the true value of the securities, which means the prices reflect all the available information. Price informativeness is important in order to allocate financial resources optimally. In an efficient capital market, savings are allocated to productive investment in a way benefiting both borrowers and lenders. Such markets are described by the efficient market hypothesis. There are also the general conditions thought to be necessary for an efficient market. Such conditions can be summarized: a large number of individuals and entities should be seeking information which randomly comes to the market, and investors should adjust security prices to reflect the new information.³³

It is hypothesized that there are various levels of efficient market. The levels differ according to the information which is assumed to reflect prices. There can be weak, semi-strong and strong models of efficient markets. What is important here is the hypothesis of the strong model; prices should reflect not only all public information, but also information known only by corporate insiders and/or stock exchange specialists. However, in reality this assumption is not plausible.³⁴

From an economic perspective, the Efficient Market Hypothesis poses the question of the importance of regulation in financial markets. In reality financial markets are not perfect, as hypothesized by financial theories. Parties to transactions are not necessarily equally informed. It is true that disclosure of information is not free, but rather costly to the issuers who spend resources to meet disclosure requirements. The same is true of the financial analysis of information which means that those who spend resources for research are better informed. It has been suggested that the measure of the informativeness of the price system

³² PETER D. SPENCER *The Structure and Regulation of Financial Markets* (Oxford: Oxford University Press, 2000), pp.104-5.

³³ ALAN A. STEPHENS AND CARYN L. BECK-DUDLEY 'The Efficient Market Theory and Insider Trading: Are We Ahead in the Right Direction?' (1989) *27 American Business Law Journal* 441. p.451.

³⁴ *ibid.*, p.454.

depends on the number of investors who are informed. When informed investors observe positive information they bid securities price up, and the so called “market information” (the number and volume of trades) is made publicly available. This means that uninformed individuals will be informed through the market system. This is, however, done imperfectly by the market system. As Grossman and Stiglitz point out, there will always be investors who are ‘in economics terms’ less informed. A slight information imperfection is inevitable, and this should be taken into consideration.³⁵ Thus, in reality it is difficult to say that a certain price reflects all the available information, a fact which means that there could be imperfect or even non-existent markets. The economics of information in financial markets makes them more prone to risk than other markets. It is at this point that regulation is used to create the necessary conditions for a financial market to execute its intermediary role effectively. Regulations in this sense are supposed to force entities to disclose information; otherwise they would not perform this costly task. This is supposed to inform investors in making their decisions, which in turn limits the systematic risk of creating an imperfect or non-existent market.³⁶

Economic arguments for and against the regulation insider dealing

Having introduced the importance of financial markets, of information and of the importance of information to an efficient market, it should be indicated that such economic hypotheses can be used for and against the regulation of insider dealing. It will, therefore, be prudent to introduce the best-known arguments and evaluate their strengths and weaknesses.

One challenge put forward against the market efficiency argument by Stephen Bainbridge³⁷ is that if the aim is to place investors on an equal footing in terms of having access to inside information, the rules governing insider dealing are not the proper method to achieve this aim. It is said that equality of information would be reached by legally compelling issuers to disclose the information likely to affect prices on a timely basis. Insider dealing is taking advantage of non-public information to be in a better dealing position. Thus, disclosure

³⁵ SANFORD J. GROSSMAN AND JOSEPH E. STIGLITZ ‘On the Impossibility of Informationally Efficient Markets’ in SUDIPTO BHATTACHARYA AND GEORGE M. CONSTANTINIDES (eds.) *Financial Markets and Incomplete Information: Frontiers of Modern Financial Theory* (Totowa : Rowman & Littlefield, 1989). pp.133-5.

³⁶ DEUTSCHE BUNDESBANK ‘Securities Market Regulation: International Approaches’ Monthly Report, January 2006. pp.36-8.

³⁷ BAINBRIDGE, STEPHEN ‘Insider Trading’ in *Encyclopedia of Law and Economics III* (Edward Elgar Publishing, Cheltenham, U.K., 2000). p.785.

requirements could be designed to keep to a minimum non-public price sensitive information in such a way that the opportunities for exploiting such information would be reduced. Disclosure requirements are a better solution than regulating insider dealing in order to achieve informativeness in the market. This leads to a questioning of the efficiency of regulating insider dealing, and supports the argument that the problem is better dealt with by continuous disclosure requirements. Stephen Bainbridge thinks that effective regulation of insider dealing requires rules relating to the timely disclosure of material information. In this regard, the equality of information theory has been criticised. It has been argued that prohibiting insider dealing on such a ground would not lead to an advanced disclosure system. This argument was put forward in the US, where the law had been unwilling to obligate issuers to disclose material non-public information. It was therefore rightly asserted that, irrespective of permitting insider dealing or not, the investors will not have the same access to information as insiders unless there is a system of timely disclosure.³⁸

Nevertheless, such criticism was accurate according to the position in the US, where there was no obligation on the issuers to make timely disclosure of inside information. While we advocate the concept that disclosure rules are the primary method of reaching market informativeness, we also think that the regulation of insider dealing has a preventive role. To be more specific, in practice not all events are clear, nor can they be announced immediately. Where there is an unexpected and significant event, the issuer needs more time to elucidate the situation. Otherwise, an immediate announcement might cause false, non-detailed or misleading disclosure. There is always a period of time before the information inside the corporation is approved and ready for disclosure. In addition, there are circumstances in which the issuer is exempted from making a timely disclosure, if it is thought that such disclosure would be detrimental to the legitimate interests of the issuer. This means that in such circumstances the information should be kept confidential.³⁹ It is these circumstances which are crucial for insider dealers, and therefore the regulation of insider dealing is essential to prevent misuse of information during this period. Thus, regulation of insider dealing has a preventive role in market informativeness. Disclosure rules alone are insufficient to achieve informativeness in the market. They could be rather

³⁸ BAINBRIDGE, STEPHEN 'Insider Trading' in *Encyclopedia of Law and Economics III* (Edward Elgar Publishing, Cheltenham, U.K., 2000). p.785.

³⁹ Timely disclosure is explained in-depth below. See heading: Part 4: the regulation of timely disclosure.

easily breached. There is a probability that insiders could avoid prompt disclosure to exploit information for their own benefit, especially where they are in an influential position in management. They can also send ambiguous disclosures and signals to create market uncertainty for their own benefit.⁴⁰ This means that the regulation of insider dealing is essential since it complements disclosure rules.

Manne based his economic arguments against regulating insider dealing on the importance of information to market efficiency. He argues that insider dealing acts as a replacement for the public disclosure of inside non-public information. He argues that when insiders deal on the basis of inside information they gradually bring the market price to a more realistic informed level. The proposition is that uninformed investors will be informed through 'market information', in other words, through the number, volume and trend of trades. He contends that a gradual adjustment is better than violent price fluctuation. He also indicates that insider dealing does affect price movements in certain circumstances in which insider dealing noticeably influences market trends, especially prior to the announcement of takeover offers. Manne suggests that the market is divided between those who deal according to available public information and those who possess inside information. Assuming the reliability of inside information, insider dealing should be allowed as insiders become the leading market influences. Insider dealing will induce others to deal in the same trend in the particular security; this will allow the market price to be more informed. Manne argues that insider dealing is an effective economic way to release information into the market. Insider dealing results in showing the real price of a share, and indirectly draws inside information into the market.⁴¹

Manne's argument is based on the concept that insider dealing changes the price to the correct price. This is an example of what Gilson and Kraakman call a 'derivatively informed trading mechanism'.⁴² This mechanism is thought to move prices through two steps. First, insiders begin trading, but their trading has only a slight effect on the price. Second, other investors in the market react to the insider's trades by trading in the same direction, which results in the price gradually moving in the right direction. However, Gilson and Kraakman point out that derivatively informed trading functions slowly and

⁴⁰ JAMES D. COX 'Insider Trading and Contracting: A Critical Response to the "Chicago School"' (1986) 4 *Duke Law Journal* 628. p.636.

⁴¹ HENRY MANNE *Insider Trading and the Stock Market* (The Free Press, 1966). pp.80-90.

⁴² GILSON, RONALD J. AND KRAAKMAN, REINIER H. 'The Mechanisms of Market Efficiency' (1984) 70 *Virginia Law Review* 549.

sporadically. Therefore, it is unlikely that allowing insider dealing will have much effect on the market efficiency.⁴³

The hypothesis of insider dealing influence on the market price is questionable. There are circumstances, like the period prior to an announcement of a takeover offer, where insider dealing is influential. But it is debatable whether this is the usual trend or an exception. Manne's argument regarding the degree and influence of insider dealing on market efficiency is theoretical, and has attracted many economic studies examining its validity.

Microeconomic studies have been carried out to analyse the influence of insider dealing on price movement. Addressing insider dealing empirically has not provided a clear-cut answer as to whether to regulate insider dealing or not. On the contrary, economic studies have widened the argument and provided more questions than answers. It is beyond the purpose of this thesis to analyse the results of all these studies. However, analysing the most important studies will reveal the debate.

In particular the main hypothesis tested by microeconomic studies is that "insider dealing moves the price of the security to the informative price had the information been disclosed". In an early study, Hsiu-Kwang Wu⁴⁴ concluded that speculative trading by insiders may be economically beneficial and restrictions may be harmful to the economy. However, he made it clear that "The fundamental principle of securities regulation – full disclosure – is not questioned here"⁴⁵. We should note that this study was conducted in the US at a time when issuers were not obligated to make timely disclosure of inside information. The other point which we emphasise is that Hsiu-Kwang Wu regarded full disclosure as a fundamental principle. Therefore, if he had been asked whether the combination of insider dealing and timely disclosure rules contributes to market efficiency, it is probable that he would have reached a different conclusion.

On the other hand, other economists concluded that the above-mentioned hypothesis is not correct and that regulating insider dealing is necessary for an efficient market. Fishman and Hagerty⁴⁶ concluded that, under certain circumstances, insider dealing causes less efficient stock prices. This is due to the adverse effect of insider dealing on competition in the

⁴³ GILSON, RONALD J. AND KRAAKMAN, REINIER H. 'The Mechanisms of Market Efficiency' (1984) 70 *Virginia Law Review* 549. p.631.

⁴⁴ HSIU-KWANG WU 'An Economist Looks at Section 16 of the Securities Exchange Act of 1934' (1968) 68 *Columbia Law Review* 260.

⁴⁵ *ibid.*, p.269.

⁴⁶ MICHAEL J. FISHMAN AND KATHLEEN M. HAGERTY 'Insider Trading and the Efficiency of Stock Prices' (1992) 23 *The RAND Journal of Economics* 106. p.118.

market and this deters others from acquiring information. Khanna⁴⁷ also decided that insider trading reduces information collection by uninformed investors; consequently, allocation efficiency is reduced. Insider dealing reduces the informational content of securities prices and the use of information termed as ‘sub-optimal’. It is important to emphasise that these two studies sustain a fundamental principle: the availability of information to all investors is a better means of achieving market efficiency. Assuming, for the sake of argument, that insider dealing moves prices in the right direction, in the long term it is expected that uninformed investors’ inability to acquire information is detrimental to the market. This was proved empirically by Fishman and Hagerty, and Khanna.

A third opinion also appeared: that insider trading may hurt or help markets and that this depends on the different characteristics of these markets. According to this view, the controversy still exists and there is no single “best” answer.⁴⁸

The economic debate continues to be unsettled, even in the primary investigation of the effect of insider dealing on market prices. There is no one single answer in microeconomics to the effect of insider dealing. Three important empirical studies have been used to support the argument that the practice significantly changes the security market price, and in the right direction. These studies are Meulbroek (1992)⁴⁹ Cornell and Sirri (1992)⁵⁰ and Chakravarty and McConnell (1997).⁵¹ The importance of these studies was furthered when they were referred to in legal literature as evidence for allowing insider dealing due to its positive effect on prices. The three studies have some elements in common. In the three cases, collected data were from cases of illegal trading by insiders. In each case the insider was a buyer. Generally, the three studies concluded that there is a correlation between insider trading and the increase in the prices of the related securities. Thus, insider dealing positively affects price discovery in a more informative trend.

Chakravarty and McConnell (1999)⁵² in a reverse finding study, challenge the three aforementioned studies and the assumption that insider dealing moves stock prices. Their new,

⁴⁷ NAVEEN KHANNA ‘Why Both Insider Trading and Non-Mandatory Disclosures Should Be Prohibited’ (1977) 18 *Managerial and Decision Economics* 667. p.677.

⁴⁸ HAYNE E. LELAND ‘Insider Trading: Should It Be Prohibited?’ (1992) 100 *The Journal of Political Economy* 859. p.883.

⁴⁹ See MEULBROEK, L. ‘An Empirical Analysis of Illegal Insider Trading’ (1992) 47 *Journal of Finance* 1661.

⁵⁰ See CORNELL, B. AND E. SIRRI ‘The Reaction of Investors and Stock Prices to Insider Trading’ (1992) 47 *Journal of Finance* 1031.

⁵¹ See CHAKRAVARTY, S. AND J. J. MCCONNELL ‘An Analysis of Prices, Bid/Ask Spreads, and Bid and Ask Depths surrounding Ivan Boesky’s Illegal Trading in Carnation Stock’ (1997) 26 *Financial Management* 18.

⁵² CHAKRAVARTY, S. AND MCCONNELL, J. J. ‘Does Insider Trading Really Move Stock Prices?’ (1999) 34 *The Journal of Financial and Quantitative Analysis* 191.

more appropriate, test was whether insider dealing has a different effect on prices than non-insider (uninformed investors) dealing. In their study of the effects of an insider (Ivan Boesky) trading on the stock price change, they found that the effects of Boesky's purchases and the purchases of others (outsiders) were not distinguishable from one another. An important public policy message was sent by this study: the three aforementioned studies cannot be depended upon to legalize insider dealing.⁵³

The disagreement between the above studies, given that the same writers happened to change their conclusions, evidently indicates that empirical microeconomic studies have not solved the effects of insider dealing. The study of Chakravarty and McConnell (1999) has had very important results. They investigated a real case of insider dealing in which the material information was non-public. The only means available to disseminate this information was through the questionable "effect of inside information on the price". However, their extensive study concluded that the trade of the insider is not distinguishable from that of other uninformed traders. Therefore, the efficiency of insider dealing in moving the price of the security to reflect the inside information is ambiguous, and cannot be used as the basis for deregulating insider dealing. It should be said that solving the economic debate on the basis of empirical findings in this area, as in other areas, is unattainable.

Although there have been controversies regarding the findings of economic studies, it can be said that the argument that insider dealing should be allowed is weak. This is because it is observed that economists do not question the fundamental principle of disclosure which underlie financial market regulation. On the contrary, they have always called for a system of obligatory disclosure in order to maintain an informed and efficient market. Those who argue that insider dealing should be allowed, base their argument on the hypothesis that it is a form of disseminating information into the market. However, it is not proven that indirect disclosure through insider dealing is more efficient than direct disclosure of the information into the market. It should also be noted that most of the studies were conducted in the US, where full disclosure of inside information is not required by the law. In other jurisdictions, where the law requires disclosure of similar information to the public, there is no place for the argument that insider dealing is a means to disseminate such information. It should also be clear that those who call for regulating insider dealing do not argue that there should be

⁵³ CHAKRAVARTY, S. AND MCCONNELL, J. J. 'Does Insider Trading Really Move Stock Prices?' (1999) 34 *The Journal of Financial and Quantitative Analysis* 191. p.208.

absolute prohibition. Their case (and this is applied in most jurisdictions) is that dealing by insiders is legitimate when they do not possess inside information.⁵⁴ In practice, their legitimate dealings provide a form of signal which is followed by other investors in the market.

Protection of investors and confidence in the market

Another rationale for regulating insider dealing is that investors should be protected in order to maintain confidence in the market. The maintenance of the integrity of the market is vital to its efficiency. Investors' rights should be protected by efficient regulation, especially their right of equal access to information. If investors perceive that the market is unfairly favoring insiders, they will not direct their investment into the market.⁵⁵ It is, therefore, an eminent view that protecting 'investor confidence' is a sufficient justification for regulating insider dealing. The negative effects of insider dealing on confidence (or, more precisely the perceived negative effects) are argued to be a convincing justification for regulation.⁵⁶ In this regard, Rider and Ashe indicate that "... the main (if not only) convincing justification for controlling insider dealing is that it has a perceived, adverse impact on confidence".⁵⁷ This view alters the underlying reasoning, from looking for any direct effects on the financial markets or the issuers of securities to the perception of investors. If investors think that insider dealing is unfair they will be pushed away from financial markets. For the financial markets to be effectively operated, confidence and integrity in them is required. Investors will only direct their funds into the market when they think that it is reasonably fairly managed and regulated. This approach is of the opinion that if investors perceive insider dealing as being unfair, economic justification is not required. In any case, economic findings here are ambiguous. In this regard, regulating insider dealing is appropriate as an intervention by the authorities to protect confidence in the integrity of the market. Although the common man's perception is likely to be criticised by scholars of jurisprudence, advocates of this view argue that such criticism is not

⁵⁴ In technical legal language such an act is not insider dealing. However, economists call such acts insider dealing.

⁵⁵ B. RIDER, CHARLES ABRAMS AND MICHAEL ASHE *Guide to the Financial Services Regulation* (Bicester 3rd: CCH Editions, 1997). p.101.

⁵⁶ B. RIDER and HL Ffrench 'Should Insider Trading be Regulated? Some Initial Considerations' (1978) *SALJ* 79. p.96-7.

⁵⁷ B. RIDER AND M. ASHE *Insider Crime: The New Law* (Bristol: Jordans, 1993). p.5.

important. It is the perception and conduct of the ordinary investor which is important here, and this has the greatest influence on the financial market.⁵⁸

If the public perception of the capital market is negative, investors will direct liquidity to alternatives, which will lead to difficulties for corporations in securing borrowing. Capital markets play a major role in allocating resources and confidence in them can be fragile. So the goal of regulation ought to be maintaining investors' confidence and, ultimately, the integrity of capital markets. Such an argument is supported by the fact that there is a link between confidence and market integrity. Evidence for such a link is apparent in the US crash of 1929, and investors' retreat to banks and savings institutions.⁵⁹

Confidence in market integrity as a fundamental has been used by different authorities in the US. Apparently, it is a common argument between different legal theories attempting to prohibit insider dealing. There has been agreement that unless insider dealing is regulated, investor confidence in the integrity of markets will weaken, leading to negative effects in the depth and liquidity of dealings.⁶⁰

One difficulty with this line of reasoning is in 'justifying' the 'investor confidence' rationale. Investor confidence as a rationale was criticised as an emotional and sentimental force which is thought to be speculative. According to this opinion, if there is a basic confidence in the integrity of the market, the additional effect of insider dealing on confidence is speculative. Therefore, justifications based on 'protecting investor confidence' are said to be unsophisticated, and the relationship between insider dealing prohibition and investor confidence is a 'myth'.⁶¹ 'Investor confidence' has also been criticised because it gives rise to the ethical question of insider dealing. Although this can be dealt with by explaining 'investor confidence' from a social perception (rather than a philosophical one) this social perception is uncertain; people think that insider dealing is unfair, but may do it if there is a strong temptation.⁶²

However, it is still true that in practice negative investor perceptions can be the result of insider dealing. Such perceptions might be irrational, but this view cannot be defended as long as there is a reason for them. Investors consider it their right to have 'equal access to

⁵⁸ B. RIDER AND M. ASHE *Insider Crime: The New Law* (Bristol: Jordans, 1993). p.6.

⁵⁹ JOHN W. BAGBY 'The Evolving Controversy over Insider Trading' (1986) 24 *American Business Law Journal* 571. p.579.

⁶⁰ DONALD C. LANGEVOORT 'Rereading "Cady, Roberts": The Ideology and Practice of Insider Trading Regulation' (1999) 99 *Columbia Law Review* 1319. p.1325.

⁶¹ *ibid.*, pp. 1327-8.

⁶² *ibid.*, p.1326.

information'. Thus, their lack of confidence is rational if insiders are allowed to be advantaged over other investors to use inside information. Thus, investor confidence is not necessarily an emotional force. Rather it is based on the rational expectation of investors that the regulatory system should treat all investors equally in terms of access to information. It is not essential, and may be unattainable, to prove empirically the link between allowing insider dealing and investor confidence. Legal theory, after all, is more familiar with principles than with empirical findings. Therefore, the regulation of insider dealing is thought to protect the rights of investors. It is an important device to maintain the confidence and integrity of the markets.

International regulatory standards

In the era of international financial markets there is the possibility of regulatory competition. It is possible for investments to switch to markets with insignificant regulation. Regulated entities take into consideration the costs of regulatory requirements; for instance, requiring a certain accounting standard costs the issuer. The cost of regulatory requirements is an incentive for investments to switch to markets with lower costs for regulatory requirements. This results in regulatory bodies involving themselves in negative competition to reduce regulation in order to attract investments. This trend is called "race to the bottom". It may result in allocating investments to risky markets, an issue which is of concern at international regulatory level. It is also possible that regulatory bodies "race to the top". Investments are attracted by highly regulated markets which limit 'systematic risk'. Market participants accept the heavier regulatory framework if their benefits exceed the costs involved. Thus, regulatory bodies may race to the top regulatory standards to attract investments. Markets with high standards of regulation are perceived as excellent markets. This results in forcing other markets to introduce more regulation to sustain their position.⁶³ An example of this trend is the Sarbanes-Oxley Act in the US. This was introduced in 2002, following accounting scandals. Although the act involves costly requirements of disclosure and accounting, it has sustained the position of the American markets, which still attract investments. We think that another example is the Dubai International Financial Centre's (DIFC) race to the top regulation to build its reputation.

⁶³ MURPHY, DALE D. *The Structure of Regulatory Competition: Corporations and Public Policies in a Global Economy* (Oxford: Oxford University Press, 2004). pp.5-8.

Through cooperation, financial regulatory authorities have helped to define standards and codes of good practice which can be accepted at an international level. This is considered advantageous, because it helps countries with emerging capital markets to implement standards, when dealing with or through the market, that other financial institutions and investors consider secure. It also encourages foreign investment and helps the international mobility of capital.⁶⁴ However, it is possible that the implementation of standards and codes leads to negative results. Regulations may have advantages or shortcomings, the perception of which is limited. Thus, it is thought that diversity of regulatory regimes should be encouraged. Markets are in competition and they would not ‘race to the bottom’, they would not necessarily implement the regime which is least restrictive if diversity of regulatory regimes was encouraged.⁶⁵

Increasing international economic integration has its effects on regulation. Financial markets in integrated economies are brought closer in terms of regulatory standards. Where regulation is standardized, financial services providers and investments may extend their activities internationally. To liberalize the financial sector, national financial regulation should reflect international standards. This is the function of the International Organization of Securities Commissions (IOSCO) the association of national securities regulators, Self-Regulatory Organizations and exchanges. The IOSCO issues recommendations to member authorities or regulatory bodies to absorb the principles of securities regulation. In 1998 IOSCO introduced the “Objectives and Principles of Securities Regulation”, consisting of 30 principles. These principles can be divided into three primary objectives of securities regulation and supervision: investor protection; market fairness, efficiency and transparency; and the limitation of systematic risk. These principles are to be absorbed in relation to various regulation and supervision areas. Some examples are: the obligations of securities issuers; the requirements for market participants and intermediaries; and the licensing and monitoring of exchanges and other trading systems.⁶⁶

The IOSCO is a voluntary association of national authorities and regulatory bodies; therefore, it is only capable of issuing recommendations. However, in 2003 the organisation introduced a detailed methodology in order to assess individual regulatory systems. This

⁶⁴ GEOFFREY WOOD ‘Competition, Regulation and Financial Stability’ in PHILIP BOOTH AND DAVID CURRIE (eds) *The Regulation of Financial Markets* (London: The Institute of Economic Affairs, 2003). p.79.

⁶⁵ *ibid.*, p.80.

⁶⁶ IOSCO (2003) *Objectives and Principles of Securities Regulation*, (URL) <<http://www.iosco.org/library/pubdocs/pdf/IOSCOPD154.pdf><http://www.iosco.org/library/pubdocs/pdf/IOSCOPD154.pdf>>, accessed on 4/12/2004.

method allows for grading members according to their implementation of IOSCO principles. It gives the recommendations of IOSCO a quasi-mandatory character. The purposes of grading regulatory systems are to provide a benchmark for self-assessment of regulatory systems, and to provide information for use by the World Bank and International Monetary Fund in their Financial System Assessment Programmes.

The international regulatory competition, or the need to gain an international reputation for national financial markets, has been an incentive to regulate insider dealing. It was perceived that insider dealing is an curious problem in the US. The SEC's efforts at regulation and enforcement in this area were considered to be rather harsh. However, this attitude has changed; now regulating insider dealing is the general trend internationally. It can be said that there is an international consensus on adopting rules prohibiting insider dealing. The trend to regulate is challenged by the histories of various countries. Some countries have no history of regulating insider dealing.⁶⁷

Allowing for the historical lack of concern in many countries, there has to be incentives to regulate insider dealing. Recent changes in the financial world appear to be sufficient reason to regulate insider dealing. Some of these reasons are competitive pressures, financial markets internationalization and technological developments.⁶⁸

There is competition at an international level to attract foreign investment; the internationalization of financial markets is an aspect of this. This explains the regulatory competition, and the 'race to the top' or 'race to the bottom'. Technological development has furthered the notion of internationalizing financial markets. Online dealing is an example of the formerly unexpected growth in cross-border transactions. Continuous technological development has also contributed to the multiple listing of securities and online dealing in a way that has significantly raised the levels of investment in financial markets. There is empirical evidence of high growth in the number of investment accounts in stockbrokerage firms, the number of transactions and the overall volume of dealings. The

⁶⁷ HARVEY L. PITT AND DAVID B. HARDISON 'Games without Frontiers: Trends in the International Response to Insider Trading' (1992) 55 *Law and Contemporary Problems, International Regulatory Competition and Securities Laws* 199. pp.200-1. The UAE, as it will be indicated in chapter 2, has no history of enforcing the rules of insider dealing.

⁶⁸ *ibid.*, p.201.

characteristics of the investor population and trends in dealing are also different.⁶⁹ At the same time, there is a probability that opportunities for insider dealing have increased.

These facts have been considered in the Market Abuse Directive,⁷⁰ which emphasizes the role of technological development in market abuse and insider dealing. It states: “New financial and technological developments enhance the incentives, means and opportunities for market abuse: through new products, new technologies, increasing cross-border activities and the internet”.⁷¹

Advances in technology are also reflected in enforcement and monitoring efforts. Market-monitoring systems have been advanced. Former systems used to identify abnormalities in the market and alert regulators for the purposes of investigation. Their function was only one of detecting abnormalities, without further information for investigation. New systems have been introduced which facilitate the unification of trading and information sources. This has helped to give signals to regulators and has provided the information required for investigation. Efforts are continuing to introduce new systems for cross-market monitoring activities. There are also attempts to innovate more sophisticated and integrated information systems for online dealing, monitoring, electronic filing and electronic disclosure.⁷²

International competition in attracting foreign investment has been an aspect of international financial markets. There had been efforts to advance securities regulation and prohibit insider dealing, in order to attract both domestic and foreign investment, as long as three decades ago.⁷³ It is logical that the level of competition should significantly increase over time. Consequently, the efforts to maintain confidence in markets by prohibiting insider dealing have advanced.

In recent times, the pressure towards more regulation has been present at both domestic and international levels. Insider dealing at international level is considered inconsistent with the principle of transparency in financial markets. Pressure to adopt standards which are supposed to protect foreign investors has been experienced on markets at an international

⁶⁹ See ANWER S. AHMED, RICHARD A. SCHNEIBLE JR. AND DOUGLAS E. STEVENS ‘An Empirical Analysis of the Effects of Online Trading on Stock Price and Trading Volume Reactions to Earnings Announcements’ (2003) 20 *Contemporary Accounting Research* 413.

⁷⁰ Directive 2003/6/EC of 28 January 2003 on insider dealing and market manipulation (market abuse) [2003] OJL 96/16.

⁷¹ *ibid.*, Recital 10.

⁷² See ADELA S. M. LAU ‘An Integrated Trading Environment: To Improve Market Transparency and Efficiency’ (2002) 5 *Review of Pacific Basin Financial Markets and Policies* 533.

⁷³ B. RIDER and H.L. French ‘Should Insider Trading be Regulated? Some Initial Considerations’ (1978) *SALJ* 79. p.100.

level.⁷⁴ The protection of financial institutions and individuals has been recently seen as an international duty, since any collapse will have effects at an international level. Countries which are recognized as not having taken sufficient steps in regulating insider dealing may endanger confidence in their financial markets.

Part 2 Legal theories in regulating insider dealing

In this section we will discuss the development of legal theories in regulating insider dealing, disregarding whether such a development is based on consideration of other disciplinary areas; for example, economic arguments which might indicate that insider dealing is a micro-economic problem. The discussion reveals how legal thought has depended upon the assertion of the legal principles on which judgments were based. This discussion is directed to the legal theories which may or may not provide a ground for the regulation of insider dealing, both in the common law jurisdictions and UAE jurisdiction. This section also makes a comparative analysis of the prospects for depending on general legal provisions to prohibit insider dealing in the UAE. Such provisions have never been used there, although they were the only available ground when there were no formal financial markets. It is important to review these general provisions, at least in theory, in order to find out whether they provide a sound basis for prohibiting insider dealing. Depending on general legal provisions to prohibit insider dealing in the UAE is difficult, as is the case in common law. Nevertheless, it is important to review these general provisions in order to discover whether they provide convincing legal grounds for regulating insider dealing.

The classical concept was to attach fiduciary obligations to the insider. This concept depends on the fact that directors owe fiduciary duties to the company. However, directors owe fiduciary duties to the company or to the shareholders collectively, but not to the shareholders individually. In the same way, directors' obligations are enforced on behalf of the shareholders collectively, not individually. Directors owe no general fiduciary duties to individual shareholders when carrying out transactions with such shareholders. In the common law the leading authority is *Percival v. Wright*,⁷⁵ in which the directors purchased shares from the company's shareholders without disclosing information regarding

⁷⁴ HARVEY L. PITT AND DAVID B. HARDISON 'Games without Frontiers: Trends in the International Response to Insider Trading' (1992) 55 *Law and Contemporary Problems, International Regulatory Competition and Securities Laws* 199. p.202.

⁷⁵ *Percival v. Wright* [1902] 2 Ch. 421.

negotiations which were taking place for selling the shares at a higher price. The directors were held to be under no duty to disclose inside information to individual shareholders which would have allowed them to sell at a higher price. It was held that a director owes no fiduciary obligation of disclosure when he deals with shareholders individually rather than through his company. This case has been a matter of controversy, because it does not seem to be fair to allow directors to profit from inside information which is not available to the other party in the transaction.

In spite of this controversy, the authority in *Percival v. Wright* has not been over-ruled by any court in the common law. But there were challenges to this decision,⁷⁶ as in the New Zealand Court of Appeal in *Coleman v. Myers*.⁷⁷ In this case, a father and son were the only directors of a family company. They worked out a plan to acquire the company through another company owned by the son. As directors, they recommended to the family company shareholders to accept a takeover offer from the son's company. In their advice they failed to disclose to the shareholders the real value of the company assets and capital dividends. The shareholders contended that their shares were under-valued and then acquired by Myers, who concealed the true value of the company's assets.

It is important to indicate that at the court of first instance Mahon J criticised *Percival v. Wright* as being wrongly decided. It should not be followed because it contradicted contemporary commercial morality. He stated: "In New Zealand, as in other Commonwealth jurisdictions, nothing has been done by the legislature to vary or abolish the effect of the decision in *Percival v. Wright* and this general reluctance on the part of legislatures to intervene in the matter may be explicable by the difficulty in constructing the appropriate statutory formula".⁷⁸

However, the Court of Appeal decided that *Percival v. Wright* was correctly decided on its facts. The decision of the court depended on the special circumstances of *Coleman v. Myers*, in the light of which it must be read. The shareholders traditionally relied on directors for information and advice, which made the latter under a fiduciary duty to advise shareholders when negotiating their share transactions. The court decided that when a director deals with an individual shareholder while in possession of material inside

⁷⁶ For a comprehensive discussion, see B. RIDER 'Percival v. Wright Per Incuriam' (1977) 40 *Modern Law Review* 471.

⁷⁷ *Coleman v. Myers* [1977] 2 NZLR 225.

⁷⁸ *ibid.*, at 273.

information, he is in the “special facts” of the case under a fiduciary duty to disclose any material information which the shareholder may use in making his decision.

The theory of fiduciary duty relies on assuming the presence of a fiduciary relationship between two parties, where one party is committed to the other by a fiduciary duty. The fiduciary relationship obliges one party to maintain sufficient care to meet his duties and to act in a loyal manner to do the tasks he undertakes on behalf of the other party. The jurisprudence in the UAE is familiar with the concept of fiduciary relationships. The Federal Company Law No. 8 of 1984 (FCL 1984) contains more than one article in which the directors of a company are assumed to owe a fiduciary duty towards the company. Article (108) of FCL No. 8 of 1984 states that⁷⁹ it is not allowed for any chairman or member of the board of directors, without preceding permission from the general meeting annually renewed, to participate in any work which conflicts the interests of the company nor to practice trade in the same area of activity of the company, either for his own account or for another. Directors’ fiduciary duties are also emphasised in Article (109) which states that a member of the board of directors, who has an interest conflicting with that of the company in an act being decided by the board, must inform the board and state it in the report of the meeting. He is also not permitted to vote in the decision to take such an act. The provisions banning directors from participating in activities which may result in a conflict of interests is based on the concept of the fiduciary duties of directors.

Use of the concept of directors’ fiduciary duties can be justified on another ground. In general, the legal jurisprudence in the UAE regards the board of directors as the agent of the company and they are obliged to represent it and protect its interests.⁸⁰ Article 221 (2) of the Commercial Transactions Law No. 18 of 1993 states that the agent shall maintain the interests of the principal, and must ensure that preventive measures have been taken to safeguard such interests and shall provide his principal with the particular information on the condition of the market within the area of his activity. It can be said that the director as an agent is obliged to protect the interests of the company wherever there is a conflict of interests.

Although it is clear that the director is in a fiduciary relationship with the company, it has not been decided whether the director is in a similar relationship with shareholders

⁷⁹ The laws of the UAE are drafted in Arabic. All the Articles in this thesis are the writer’s translation.

⁸⁰ AHMED AL-MELHEM, ‘Insider Dealing in the Companies Act of Kuwait No. 15 of 1960’ (1988) 13 *Arab Law Quarterly* 3. pp.12-3.

individually. A similar difficulty is found in Common Law. Thus, if a director bought or sold shares from a shareholder, it is not clear whether he is obliged to disclose any inside information in his possession.

According to the notion of breach of fiduciary relationships, insider dealing regulation is derived from identifying that a precise legal relationship has been breached. Legal authority tried to consider corporate insiders as fiduciaries who owe a disclosure duty based on a pre-existing relationship. Insider dealing regulation has been justified on the ground that the insider is in a position of trust; he/she should be legally liable when breaching the trust for his/her personal gain. In this regard, the insider should be liable to return any profit he/she has made due to his/her breach of trust. The notion of harm in this sense is understood to be in breaching the trust, rather than looking for any perceived harm to any other party.⁸¹ However, the problem with this line of reasoning is that it is only applicable to situations where there is a former fiduciary relationship between the source of information and the insider. Thus, the pre-existing relationship raises an obligation of trust, the breach of which is a justification for insider dealing regulation. A person can be held liable, according to this approach, only when he is a fiduciary. Nevertheless, a considerable number of those likely to deal while in possession of inside information are not in a fiduciary relationship. The problem here is that a person can be an insider if he/she has access to the inside information or the information is passed to him/her from an inside source. In other words, the issue is whether liability can arise where those who misuse inside information are not fiduciaries. Therefore, although the fiduciary approach constitutes a reasonable legal ground for the liability of fiduciaries, it is limited as an approach for regulating other forms of insider dealing and solving other related problems.⁸²

It is obvious that in common law any challenge to outlaw insider dealing has been discontinued when faced by *Percival v. Wright*. To prohibit insider dealing there had to be legislative intervention. In the US, Common Law development has been diverted to legislation as reflected in the Securities Act of 1933 and the Securities Exchange Act of 1934. The adoption of these Acts has not directly regulated insider dealing. Regulating insider dealing in the US has been developed by the SEC and judicial precedents. In

⁸¹ For a discussion of trust and fiduciary duties, see PAUL L. DAVIES 'Director's Fiduciary Duties and Individual Shareholders' in MCKENDRICK, EWAN, (ed) *Commercial Aspects of Trusts and Fiduciary Obligations* (Oxford: Oxford University Press, 1992).

⁸² LOUIS LOSS 'The Fiduciary Concept as applied to trading by corporate "insiders" in the United States' (1970) 33 *Modern Law Review* 34. pp. 51-52.

particular, the prominent legal problem has been in finding the ground for liability for those ‘outside’ the corporation who misuse inside information. Therefore, different legal theories have been used to determine the definition of insiders, and therefore to apply accepted legal norms. Courts have used their interpretative authority to develop the law prohibiting insider dealing, especially Section 10(b) and Rule 10b-5.⁸³ From this point, the vast bulk of law scholarship on insider dealing in the US has emerged.⁸⁴ To avoid the gap which allows non-fiduciaries to escape liability, there has to be other grounds for liability than breach of fiduciary duties.

Another theory which attempts to provide a ground for the regulation of insider dealing is the ‘misappropriation theory’. The regulation of insider dealing has been justified on the basis that it regards information as a property belonging to the issuer of the securities. In fact, this is the current position in the US. Any person’s use of the information for his or another’s personal benefit would amount to contradicting the owner’s interests. In this regard, insider dealing is a misappropriation of the inside information which is the property of its source. This justification has been proposed in the US as the ‘misappropriation theory’. However, the inside information will only be considered in the US as a property when it is misappropriated in breach of a fiduciary relationship.⁸⁵ Hence, the argument arises in this approach that not merely misusing information is a justification for liability; there should also be a determination of what information and in which circumstances it should not be misused. In other words, in order to hold an individual liable for any misappropriation, there should be an obligation on the individual not to misuse the information. This kind of obligation is usually founded on a fiduciary relationship, but the fiduciary duty here is quite different. The ‘insider’ need not owe the duty to the other party with whom he deals, nor has he to owe the duty to the issuer of the subjected securities. The duty is owed to the source of the information.⁸⁶ There has been another explanation for such a duty. This attempts to attach the obligation to the information in a way where

⁸³ This will be explained in chapters 4 and 5. It is important here to indicate how legal theories were stimulated in the US.

⁸⁴ BAINBRIDGE STEPHEN ‘Insider Trading’ in *Encyclopedia of Law and Economics III* (Cheltenham, U.K.: Edward Elgar Publishing, 2000). p.773.

⁸⁵ *U.S. v. Carpenter*, 791 F.2d 1024 (2d Cir. 1986), on appeal 484 U.S. 19 (1987).

⁸⁶ BAINBRIDGE STEPHEN ‘Insider Trading’ in *Encyclopedia of Law and Economics III* (Cheltenham, U.K.: Edward Elgar Publishing, 2000). p.776.

anyone who possesses it, with a knowledge that its transfer is in breach of a fiduciary obligation, will also be under a fiduciary obligation not to misappropriate it.⁸⁷

In the UAE, in an identical concept to the misappropriation theory, Article (322) of FCL No. 8 of 1984 stipulates a punishment of imprisonment or a fine upon each manager, member of the board of directors, member of a supervisory board, consultant, expert, accountant or his assistant, or anyone delegated to investigate the company, who divulges that which has reached him by virtue of his work in the company secrets, or who abuses such secrets to bring benefit to himself or to another person. This ban represents the importance of ‘business secrets’, which gained protection in the UAE from a wide range of insiders. Article (322) expressly mentions the insiders who are banned from abusing the company’s secrets. Therefore, this ban is limited and cannot be used to prevent secondary insiders who are not in a relationship with the company mentioned in Article (322) and who obtain a company secret. It should be mentioned that the aim of Article (322) is to protect the company’s secrets, not to regulate insider dealing. The scope of inside information is different from that of secrets. Inside information is information which is not generally available and, in most of the cases, ought to be disclosed; in these characteristics it can be different from secrets. A public company has commitments to shareholders, investors and creditors. It has to disclose inside information regularly. The only situation in which a company can preserve information from disclosure is in circumstances in which the company has reasonable grounds for thinking that disclosure will affect its interests; these could be ‘secrets’.

The ‘misappropriation’ theory brings into question the legal issue of considering information as property. Information in general has not been recognized as a form of property, but there have been attempts to distinguish certain types of information as worthy of the label of ‘property’. There has been recognition of information which is of a transactional value to those who collate, develop or process it, but accepting it as property is controversial.⁸⁸ There has been a demand for a statutory misappropriation law to protect this types of information. On the other hand, recognizing information as property has been rejected on the grounds that this will allow a private monopoly of information which ought

⁸⁷ B. RIDER AND M. ASHE *Insider Crime: The New Law* (Bristol: Jordans, 1993). p.5. and footnote 26 in p.8.

⁸⁸ ASSAFA ENDESHAW ‘Treating Intellectual Capital as Property: The Vexed Issues’ (2001) 23 *European Intellectual Property Review* 140. p.141.

also to be available to the public.⁸⁹ It is noted that these arguments are related to corporate inside information. The principle that inside information has to be disclosed is not absolute. There are situations in which the law allows non-disclosure if it is for the benefit of the issuer. For example, a company's future plans, which should be kept secret for a period of time, because they will lose their value if known to the company's competitors.

It has been observed that the recognition of information as property is important to sustain the misappropriation theory. However, assuming that the issue of property right to information is solved, there still arises the problem of determining the issues of ownership and possession. Misappropriation theory is criticised because it assigns ownership of non-public information to an employee or principal, and ignores the wider range of relationships. This suggests that the public shareholders may also have a right to such information.⁹⁰ In fact, our discussion of the US law will indicate how the SEC and the courts, in adopting the 'misappropriation theory', departed from the purpose of regulating insider dealing. The main problem of this theory is that it attaches no importance to the protection of the other party in the transaction, or to the protection of investors in the case of dealing in a market. In addition, this theory provides no answer regarding the importance of disclosing material non-public information to the other party in the transaction. Therefore, the misappropriation theory pays no attention to the real reason behind regulating insider dealing: informativeness of transactions and of the market.

Another ground for the regulation of insider dealing is 'equality of information'. This ground was reflected in the 'disclose or abstain' rule in the US. The SEC maintained that one aim of the Securities Exchange Act 1934 was to put investors on an equal footing in terms of access to corporate information. On this basis, the SEC in the case of *In re Cady Roberts & Co.*,⁹¹ held liable a broker who had access to inside information and dealt on the basis of such information. The legal basis was the 'disclose or abstain rule', which is clearly based on equality of information. The SEC ruled that the broker who possessed material non-public information should have disclosed such information or abstained from dealing until the information was made public. The SEC ruling in *Cady* was supported by a

⁸⁹ See JAMES BOYLE 'A Theory of Law and Information: Copyright, Spleens, Blackmail, and Insider Trading' (1992) 80 *California Law Review* 1413.

⁹⁰ REINIER KRAAKMAN 'The Legal Theory of Insider Trading Regulation in the United States' in KLAUS HOPT AND EDDY WYMEERSCH (eds.) *European Insider Dealing* (London: Butterworths, 1991). p.46.

⁹¹ *In re Cady Roberts & Co.* 40 SEC 907 (1961).

federal circuit court in the case *SEC v. Texas Gulf Sulphur Co.*⁹² The court reasoned in its judgment that all investors trading in the marketplace should have equal access to material information.⁹³

An equivalent ground to 'equality of information' can be identified in UAE law in the provisions relating to misrepresentation. Misrepresentation is a defect of will which allows the misrepresented party to request nullification. Article (185) of the Civil Transactions Law No. 5 of 1985 defines misrepresentation as where one of the contracting parties deceives the other by fraudulent means, saying or acting, which leads the other party to consent to what he would not otherwise have consented to. It appears that there are four conditions for an act to be misrepresentation: 1- the use of fraudulent means; 2- the deceiving party's connection with the misrepresentation, in other words he acted by fraudulent means or he knew that another did so; 3 -the misrepresentation shall be the cause of the other party's consent; and 4- gross cheating resulted from the misrepresentation, as the misrepresented party could not require nullification for a slight difference in price.⁹⁴

Article (186) states that deliberate silence concerning a fact or a circumstance shall be deemed as misleading to a person who would not have made the contract had he known that fact or circumstance. The contracting party may be obliged to disclose information to the other party in regard to the transaction. The provenance of such an obligation could be the law or the nature of the contract.⁹⁵

Accepting the general provisions in regard to misrepresentation in UAE law, the question is, could the insider be regarded as making a representation to the other party? In general, an insider does not disclose important information to the other party who would not have made the contract had he known that information. His silence could be regarded as a fraudulent means pushing the other party to consent. It can be argued that transactions of securities are of a special nature. This is because in such transactions the disclosure of related information is essential for the other party to make a decision.

The misrepresentation theory seems to provide a sound ground that can be used against both primary and secondary insiders, wherever they do not disclose important information

⁹² *SEC v. Texas Gulf Sulphur Co.*, 401 F.2d 833 (2d Cir. 1968), cert. denied, 394 U.S. 976 (1969). For background to the case in more detail see, WILLIAM H. PAINTER 'Inside Information: Growing Pains for the Development of Federal Corporation Law under Rule 10b-5' (1965) 65 *Columbia Law Review* 1361.

⁹³ This is a short indication of the 'disclose or abstain' rule in the US, which is discussed below in-depth. See heading: The 'disclose or abstain rule'.

⁹⁴ Ali Najidah, *General Theory of Obligations: Sources of Obligation (Traslation from Arabic)*.

علي نجيدة، النظرية العامة للإلتزام، الكتاب الأول، مصادر الإلتزام (دبي: كلية شرطة دبي، ١٩٩٣). ص ٢١١-٢١٨.

⁹⁵ *ibid.*

of a securities transaction to the other party. However, even the misrepresentation theory is limited in covering marketplace dealings. In most securities transactions the counter party is undetermined, as the electronic system randomly matches supply with demand. Only in limited situations, like Over the Counter (OTC) markets, can the two parties be determined. Misrepresentation in the UAE can only be a ground for a civil action. Where the misrepresented party takes the action he is challenged to satisfy the above-mentioned four conditions. Article (185) requires that the misrepresentation shall be the cause of the other party's consent. This is likely to be proved in private company share transactions preceded by negotiation. In market transactions, the two parties do not meet each other. The buyer or seller in the market may have done so regardless of the misrepresentation. Article (185) also addresses misrepresentation resulting in gross cheating. If the insider possesses good news, he buys securities from another who makes a profit by the transaction; it is difficult for the other party to prove any gross cheating. Overall, provided that most of the difficulties are in proof of misrepresentation, in theory there is no convincing argument why 'misrepresentation' should not be a sound ground for a civil action.

All things considered, the 'equality of information' theory seemingly provides a valid ground in law for the regulation of inside information. Having introduced the most dominant legal theories which may provide a legal basis for the regulation of insider dealing, it can be said that the 'equality of information' theory appears to be the most relevant. This theory appears to be the premise of market informativeness, which in turn requires effective regulation of insider dealing and disclosure.

The discussion also involved investigating whether a sound legal theory can be devised from the general legal provisions of UAE law. It should be mentioned here that there is no known judicial precedent which challenges the applicability of these provisions to dealings in securities. In UAE jurisdiction, securities regulation does not regulate insider dealing outside the regulated market. Thus, the plaintiff may challenge the insider's liability, depending on any general provisions available, whether 'fiduciary duties', 'misappropriation' or 'misrepresentation'. However, the jurisprudence in the UAE has not developed in this area. Thus, although general provisions can be depended on in theory, in practice for an action in this area there is little potential for success.

Market regulation of insider dealing

Having introduced the main general legal rules which could be related to insider dealing, it is apparent that there is no general rule which can be depended on to regulate insider dealing. This is the situation in common law as well as in UAE law. However, there are legal norms which underlie these general laws. Any regulation of insider dealing introduced should be based on accepted legal principles. The most appropriate principle seems to be that of the 'equal bargaining positions' of the parties to a contract. Based on this principle, it can be said that there should be 'equal access to information' for all those in the market who need such information to make investment decisions.

It seems prudent to discuss the problem of insider dealing in the light of financial market regulation. Insider dealing is largely a financial market problem, because of the fact that almost all the transactions in securities or other financial investments take place in the financial market. It is, therefore, not surprising that in most of the jurisdictions insider dealing is a market place activity, the best solution for which is confronting it by financial market regulation. Regulation in the marketplace has the role of the law in society. If we agree on the proposition that the law is about protecting interests, we can argue that regulation has an identical role in the market. If we are to look at the interests which are protected by the regulation of insider dealing, three main areas can be identified: protection of the market, of investors and of information. Legal systems and financial market regulation in different countries vary in their treatment of these interests.⁹⁶

In any ordinary market for goods or services the law provides the framework governing transactions. This had been the case in financial markets for a long time. However, financial markets have developed to an extent where the general law is inadequate to govern the complex transactions in the marketplace. One important area in which the general law seems insufficient governs the severe dependence of investors on asymmetry of information. We have discussed the shortcomings of the general law in obligating a party to disclose material information to the other party. The general law is even limited in obligating the director to disclose material information to individual shareholders when they deal with him. Iain MacNeil⁹⁷ stresses the importance of regulation for financial market. He gives an example where a small group of shareholders own and manage a

⁹⁶ ALAIN VIANDIER 'The Legal Theory of Insider Regulation in Europe' in KLAUS HOPT AND EDDY WYMEERSCH (eds.) *European Insider Dealing* (London: Butterworths, 1991). p.62.

⁹⁷ IAIN MACNEIL *An Introduction to the Law on Financial Investment* (Oxford ; Portland, Or. : Hart, 2005). p.27-8.

company. If they decide to raise more capital through a public offering, the situation will be that their knowledge of the company is superior to that of the new investors. In this case, depending on the general provisions of the contract law would result in very limited disclosure of information. Contract law, as we have discussed, may not require full disclosure of material information to the other party. It is at this point that regulation intervenes to maintain a standard of information disclosure; such a standard is special to financial markets. Otherwise, there will be parties who lack access to the material information necessary for them to make the investment decision.

One important observation made from the above discussion is that there is a point of resemblance between the regulatory obligation to disclose material information into the market and the general law obligation to disclose information to the other party. It could be argued that a merit of ‘equality of information’ underlies the obligation in both cases. On this line of reasoning, arguing that particular regulation should be dedicated to confronting the problem of insider dealing does not mean that we depart from legal norms. On the contrary, the demand for regulatory intervention to obligate information disclosure and prevent insider dealing has its origin in conventional legal theory. The closest related theoretical background seems to be that of ‘equality of information’. At this point, the argument is that there is a need for rigorous regulation because of the special nature of financial markets.

It is acknowledged that regulation is an important component of financial markets in order to maintain confidence and govern market activities. Thus, regulatory systems have their different approaches to regulation, but they have main areas in common on which to concentrate. One of the most important areas is to assure market transparency through imposing a system of obligatory disclosure and, at the same time, preventing activities such as insider dealing and market abuse which affect market transparency. The maintenance of a transparent market is essential to protect the integrity of the market, the informativeness of the investment prices, the protection of investors and, in general, the protection of the necessary confidence in the market.

Examples of policies of regulation

In the US there has been a struggle with different theories to justify prohibiting insider dealing and to draw the scope of such a prohibition. The ‘disclose or abstain’ rule was based on the rationale of equality of information. However, this rule was rejected by the

courts and the current adopted rationale is that insider dealing is ‘misappropriation’ of inside information. It appears that the ‘misappropriation theory’ does not reflect the aims of the federal securities acts, especially that of disclosure, and the protection of investors and of the market.⁹⁸ In the UK, introducing legislative prohibition is based on the rationale of equality of information, protection of investors and of the market. The shift from the former notion of depending on general legal theories had been through implementing the European Community Directive on Insider Dealing.⁹⁹ This Directive in its turn adopted a rationale of ensuring the smooth operation of the market and protecting investor confidence, which would be weakened by insider dealing. The Directive includes provisions which define the conduct subject to prohibition. Moreover, in an attempt to show that it is derived from an underlying philosophy, the Directive indicates that the objective of regulation is to ensure the protection of investor confidence and to place them on an equal footing. The Directive in its preamble signifies the importance of secondary securities markets in the economy, emphasizing that efforts should be directed to regulating such markets to ensure their smooth operation. Investor confidence, the Directive states, is an important element in the smooth operation of secondary markets. Protecting investor confidence includes an assertion that investors are placed on an equal footing in terms of information. The preamble of the Directive states:

“...Whereas the secondary market in transferable securities plays an important role in the financing of economic agents;
Whereas, for the market to be able to play its role effectively, every measure should be taken to ensure that market operates smoothly;
Whereas the smooth operation of that market depends to a large extent on the confidence it inspires in investors;
Whereas the factors on which such confidence depends include the assurance afforded to investors that they are placed on an equal footing and that they will be protected against the improper use of inside information;
Whereas, by benefiting certain investors as compared with others, insider dealing is likely to undermine that confidence and may therefore prejudice the smooth operation of the market;
Whereas the necessary measures should therefore be taken to combat insider dealing...”¹⁰⁰

⁹⁸ Will be explained in more details in chapter 4.

⁹⁹ Council Directive 89/592 of 13 November 1989 coordinating regulations on insider dealing, OJL 334/30 (1989).

¹⁰⁰ *ibid.*

From this preamble it is apparent that philosophies of regulation have been replaced by practical rationales. In a sense, the concept of equality in the market is clearly the guiding principle, along with the principle of protecting investor confidence in the market. A similar attitude has been apparent in the UK in the discussions of bills. In the Committee stage of the Companies Bill 1980, Mr. Cecil Parkinson MP indicated that “people who involve themselves in insider dealings are in the process of destroying confidence in the market”. In discussing the Criminal Justice Bill, Earl Ferrers stated that “in order to operate successfully, those markets require investors to have confidence in their fairness. Insider dealing destroys that confidence”.¹⁰¹ In discussions on the same bill, Members of Parliament accepted the justification set out by the Government, that it is based on the importance of the securities markets and the protection of investor confidence in their fairness. Insider dealing prohibition is based on its negative effects on confidence.¹⁰² It seems that the philosophy on which regulating insider dealing is based results in the scope of the regulation. In the UK, the central justification was protecting confidence in the integrity of the market. This amounted to a departure from the traditional concept of regarding insider dealing as a breach of fiduciary relationships. Therefore, under the Criminal Justice Act 1993 (as we shall see) there is a wider scope for the definition of insider and inside information. It is not necessary for the insider to be under a fiduciary obligation arising out of a fiduciary relationship with the issuer of securities or the source of information. The notions of fiduciary duties, director duties and confidential information are taken from a company law perspective. They have been replaced by notions of protecting confidence in market fairness. Under the fiduciary model, insider dealing regulation would be directed to the relationship between the insider and the company to which he owed a fiduciary duty, while under a market regime approach the concentration is on the relationship between insiders and other parties and traders in the market. The difference between the two approaches means that there is a relationship between the underlying rationale and the category and scope of adopted regulation.¹⁰³

¹⁰¹ Parliamentary Debates, House of Lords, 3 November 1992, col 1352.

¹⁰² MATTHEW WHITE ‘The Implications For Securities Regulation Of New Insider Dealing Provisions In The Criminal Justice Act’ (1995) 16 *Company Lawyer* 163. p.163; and MICHAEL ASHE ‘The Directive on Insider Dealing’ (1992) 13 *Company Lawyer* 15. p.15.

¹⁰³ PAUL L. DAVIES ‘The European Community’s Directive on Insider Dealing: From Company Law to Securities Markets Regulation?’ (1991) 11 *Oxford Journal of Legal Studies* 92. pp.92-94.

The same line of rationale was apparent in adopting the Market Abuse Directive.¹⁰⁴ Here, the preamble adopts a market protection approach, which depends on the role of transparency for public confidence, and therefore on the efficiency of the market. It states that:

“Whereas... (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.

(12) Market abuse consists of insider dealing and market manipulation. The objective of legislation against insider dealing is the same as that of legislation against market manipulation: to ensure the integrity of Community financial markets and to enhance investor confidence in those markets. It is therefore advisable to adopt combined rules to combat both insider dealing and market manipulation...

(15) Insider dealing and market manipulation prevent full and proper market transparency, which is a prerequisite for trading for all economic actors in integrated financial markets”.¹⁰⁵

Conclusion

This chapter has dealt mainly with questions of the justifications underlying the regulation of insider dealing. However, in the second place it has answered the question of whether to depend on general legal rules or to introduce regulation of insider dealing. It can be argued that the legal, ethical and economic grounds of the regulation of insider dealing can be read in the light of the practical principles of financial market regulation. Emphasis should be given to the importance of financial market regulation as an umbrella under which insider dealing will be examined. In this regard, insider dealing is assumed to have negative effects on an informed market, on transparency and on confidence in the market, and that international standards require its regulation. The modern trend shows a departure from the consideration of insider dealing as a breach of fiduciary relationship to a consideration of insider dealing as largely a market place problem. Hereinafter, the thesis will concentrate on the regulation of insider dealing in financial markets. This chapter has attempted to discuss the relevant legal, ethical and economic theories. Seemingly, the prevalent rationale for the regulation of insider dealing is that it is against ‘equality of information’. This is because ‘equality of information’ as a principle has its origins in legal norms, it is ethically

¹⁰⁴ Directive 2003/6/EC of 28 January 2003 on insider dealing and market manipulation (market abuse) [2003] OJL 96/16.

¹⁰⁵ *ibid.*, Recitals 2, 12 and 15.

prevailing and, most importantly, it is a premise for market transparency and informativeness. 'Equality of information' as a principle is far more important in financial markets than in any other market of goods or services. The theories of market efficiency and market informativeness, and practical needs such as those to protect the market and the investors and to implement international standards, all provide the premises for the arguments in this study. Probably the most important result of submitting ourselves to the 'equality of information' and 'market informativeness' approaches is that of accepting the proposition that disclosure should be regarded as the main method of market informativeness, while regulating insider dealing is a preventive method. In more specific terms, the prevailing premise seems to be that if the aspiration is 'equal access to information', the regulation of insider dealing is to serve a preventive function which is to discourage inequality of information.

Chapter 2: the law and the problem of insider dealing in the UAE

Introduction

The history of financial markets in the UAE

 The informal and unregulated over-the-counter market

 The launch of formal financial markets

 Shortfall in the enforcement of the timely disclosure and insider dealing regulation

The law of securities markets in the UAE

 Insider dealing regulation in local financial markets in the UAE

 The regulation of timely disclosure in the UAE

Conclusion

Introduction

The second chapter is more specific than the first, in that it discusses the problem of insider dealing regulation in the UAE. This chapter aims at investigating both the law and history of the development of financial market regulation. Specifically, it analyses the shortcomings in the regulation of insider dealing in the UAE. It should be noted that the efficiency of any legal interventionist policy is better evaluated if it is reviewed in the light of an understanding of the socio-economic nature of the problem. In the UAE, the development of financial markets through more than one stage and the deteriorations reflect the inconsistency of regulation. This chapter also functions as a theoretical background to the applied study, raising a hypothesis which needs to be tested.

This chapter examines the transmission from informal to formal securities markets. It will provide a history of financial markets in the UAE, representing the difference between the two stages; how absence of regulation forged the economics of the informal market and how regulation has played a major role in the economics of the formal markets.

The establishment of formal markets was properly represented in promulgating the law establishing the markets and the regulating authority. Federal Law No.4 of 2000 Concerning the Emirates Securities and Commodities Authority and Market was adopted. In this regard, this chapter briefly analyses the rules relating to the regulation of insider dealing, emphasizing their shortcomings.

The history of financial markets in the UAE

A succinct introduction to the history of financial markets is necessary in order to comprehend financial market regulation in the UAE. This discussion aims at identifying the importance of both regulation and absence of regulation in the economics of financial markets. The evolution of financial markets in the UAE can be traced in two crucial stages. The first stage is the informal and unregulated over-the-counter (OTC) market which had operated in the absence of any bourse and regulation. The second stage is the formal market since formal bourses and regulation have been introduced.

The informal and unregulated over-the-counter market

Securities have been traded in the UAE since the 1970s; nevertheless, the trading was accomplished through an informal and unregulated OTC market until the year 2000. In the 1970s the increase in oil prices resulted in the flourishing of other aspects of the UAE

economy. Local governments, individuals and families established a number of companies at this time, before the introduction of company law. Share exchange at that time was limited and there was no brokerage.¹⁰⁶

In 1982 there were serious attempts to establish a securities market. Unfortunately, such attempts stopped for several reasons, the most significant being the deterioration of the neighbouring Kuwait financial market. This deterioration had impacts on UAE investors and companies.¹⁰⁷

In the following period, the UAE experienced economic deflation. In spite of the introduction of Federal Company Law Number 8 of 1984 (FCL 8(1984)) the actual application of the law took several years. Due to the economic deflation and shareholders' need for liquidity, there was little trading in shares. In the same period three financial brokers were established, one in Sharjah and two in Abu Dhabi.¹⁰⁸

The economy of the UAE flourished again in 1988. Securities markets again appeared as essential to investment revenue. There was a society of active traders speculating in securities. By this time, FCL 8 (1984) had been applied and legal-financial awareness was raised. Accordingly, the Abu Dhabi National Bank established an index for securities prices in 1988; this was the first index in the UAE. It began with indicating the prices of 22 of the most active issuers of securities, which constituted 95% of securities traded in the market. There was active trading in the securities of 26 issuers, the market price of which was Dh21.4bn¹⁰⁹ by the end of 1988. This market price increased to Dh36.1bn by the end of 1994.¹¹⁰

In 1995 new corporations were established following a 10-year halt. In the period between 1993 and 1998, 15 companies were floated. Consequently, there was an increase in the number of investors and speculators. There was also an enhanced corporate performance, and encouraging financial results and dividends. All these factors resulted in rises in the prices of securities. Intensive speculation reached a peak in September 1998. Informal statistics indicate that the market price of traded securities was around Dh51bn at the beginning of the 1998. The market price had soared to Dh182bn by August 1998, and then

¹⁰⁶ Emad Salam, *Crisis Management in Arab and International Securities Markets and Sustained Development* (Traslation from Arabic).

عماد صالح سلام، *إدارة الأزمات في بورصات الأوراق المالية العربية و العالمية والتنمية المتواصلة* (أبو ظبي: ٢٠٠٢). ص ٢١٦.

¹⁰⁷ *ibid.*

¹⁰⁸ *ibid.*

¹⁰⁹ Dh: The currency of the United Arab Emirates is Dirham.

¹¹⁰ *ibid.*

it declined sharply to Dh161bn in September 1998. While the book value of traded securities was only Dh16.6bn, it was distributed to different sectors as follows: 51% banks, 44% services and 5% insurance.¹¹¹

Investors and dealers realised by mid-September 1998 that securities were over-priced and that intensive speculation had created a bubble. Uncertainty regarding a fair price pushed investors to liquidise their portfolios as soon as they could. The large volume of offers caused deterioration in the total market price to Dh88.8bn by the end of 1998. Apart from inhibiting new corporations from issuing initial securities, the formal response was disappointing at the time. The deteriorating trend continued in the following two years. By the end of 1999 there was trading in 46 issuers' securities and the number of brokers had risen to 50. However, confidence in the market had been dented, causing a decline in the total market price to Dh80.3bn by the end of 2000.¹¹²

It is significant that, in the absence of a formal market, the informal market was enormous compared to other financial markets in Arab countries. At the end of 1998 the informal market in the UAE was the second in total market volume in Arab countries, after the Saudi market. There are informal statistics which show the bubble in securities prices because of the increased liquidity.¹¹³

A significant volume of trading was conducted in an informal market with an absence of essential financial regulation. Proper pricing of securities (which depends on corporate performance) disclosure and market mechanisms, were unattainable. Securities pricing depended on rumours and 'cattle behaviour', as unaware traders follow the trend. There was so much ignorance because some never thought that there would be a decline in prices. The only thought was that prices only rise. Absence of regulation and ignorance were exploited by some experienced traders, some of them coming from neighbouring regulated markets. They abused every aspect of the informal market to benefit from it. In the absence of regulation and a competent authority, most of the actors could not be held liable.

The International Monetary Fund, in its report regarding Financial System Stability Assessment in the UAE,¹¹⁴ commented that:

¹¹¹ ABU DHABI NATIONAL BANK, *Economic and Financial Bulletin*, (February 1999). p.11.

¹¹² Emaad Salam, *op. cit.*

¹¹³ EMIRATES INDUSTRIAL BANK, October 1998. p.2.

¹¹⁴ INTERNATIONAL MONETARY FUND, United Arab Emirates: Financial System Stability Assessment, including reports on the Observation of Standards and Codes on the following topics: Monetary and Financial Policy Transparency, Banking Supervision and Payment Systems. (Washington, D.C.: International Monetary Fund, 2003).

The absence of effective regulation and reliable and accurate market information, combined with the closely held nature of many of the publicly held companies, created a perception that the market was susceptible to abuse by insiders as well as other forms of market malpractice.¹¹⁵

The report also added that:

During 1997 and 1998, the UAE securities markets were characterised by extreme price volatility. It was believed that market manipulation and insider dealing contributed to this condition ...¹¹⁶

It is worth considering what a local writer sees: that the financial deterioration of the summer of 1998 should have been predicted for several reasons.¹¹⁷ In addition to local investment, there was a liberal economic and investment policy which allowed foreign investment. Both these entered the informal market as investment revenue. However, in an absence of essential financial regulation it should have been clear that the fragile informal market would collapse. There was a need for a body of laws and regulations to govern the business. In particular, there was a need for maintaining a system which provided information for all investors. There was an absence of any system which governed disseminating information and the prevention of exploitation. The only possible way of obtaining information was through general meetings. However, there was also an absence of proper, efficient general meetings, which should have examined corporations' accounts and discussed their business. Accountancy principles were not properly applied. The causes of the 1998 deterioration can be summarised under the umbrella of lack of detailed applicable financial laws and regulations.

In this fragile informal market, the above-mentioned factors resulted in the spread of misconduct which caused the crash and further reflected on the national economy. There was increasing demand for securities, especially those which had been newly issued and supported by governmental contributions. Emaar Properties PLC was the main example. This demand was compounded by a false market caused by artificial dealings. The price of securities soared to unrealistic levels, peaked in the summer of 1998 and declined sharply when investors realised that the securities were overpriced. It is undeniable that there was actual abuse of the unofficial securities market. This is an acknowledged fact, even though

¹¹⁵ INTERNATIONAL MONETARY FUND, op. cit., p.19.

¹¹⁶ *ibid.*, p.19, footnote 10.

¹¹⁷ Najeeb Alshamsi, *The Investment Atmosphere in the UAE* (Translation from Arabic).

نجيب عبدالله الشامسي، *المناخ الإستثماري في الإمارات العربية المتحدة: المقومات والتحديات و الفرص* (رأس الخيمة: المسار للدراسات، ٢٠٠١). ص ١٢٥.

there was no investigation. After all, there were no specific legal rules which could have been applied to market abusers.

The informal market deterioration in the summer of 1998 provides a ground for the argument that insider dealing and other market misconducts are common in markets which are not governed by stringent regulation. The main aspect of the informal market was the absence of any disclosure system, which would have provided equal access to information for all investors. The following actions which led to the crash were common and not prohibited by the law.¹¹⁸ Certain writers, purportedly financial experts, misled investors, either intentionally or unintentionally through their analysis and predictions regarding the prices of securities. Some analysts contributed by urging small investors to participate in dealings. The recommendations of analysts who have columns in UAE newspapers influenced inexperienced investors. Because investors were individuals, and some of them had insufficient knowledge of investment, they followed unreliable analysis and there was considerable loss when they purchased securities at peak prices.

There was also misconduct by registered and unregistered brokers, who found in the situation a profitable opportunity. Most of the brokers had no understanding of the situation of issuers. Big investors also exploited the situation by contributing to the spread of rumours. Some of them passed such rumours through brokers, sometimes paying them in order to raise to the prices of their securities. When prices reached unrealistic levels, most of the big investors sold their portfolios to small investors who were unaware of the game being played.¹¹⁹

The delay until 2000 in the establishment of financial markets seems to have been a defective decision. The reasons for such a delay are difficult to justify. Establishing a financial market had been a vision for both local and foreign investors, but when it was planned to start in the early 1980s the Kuwait financial market crash prevented its opening. In the early 1990s the plan was on the table again, encouraging the flourishing economy of the country at that time. However, uncertainty and hesitation delayed the establishment of a financial market. Following this, the plan was set back by the Second Gulf War and (in the late 1990s) a the crash in Asian economies. These provided further excuses for delay and taking more time to make a decision. However, the crash in the UAE in the summer of

¹¹⁸ Najeeb Alshamsi, *The Investment Atmosphere in the UAE* (Translation from Arabic).

نجيب عبدالله الشامسي، *المناخ الإستثماري في الإمارات العربية المتحدة: المقومات والتحديات و الفرص* (رأس الخيمة: المسار للدراسات، ٢٠٠١). ص ١٢٥.

¹¹⁹ *ibid.*

1998 provided a sufficient trigger for reconsidering establishing a financial market. It was following this crash that the UAE authorities decided to establish an effective regulatory regime to improve market mechanisms and protect its integrity.¹²⁰

Justifications for the delay in establishing a regulated market seem, on the face of it, to be unconvincing because such a delay was the reason for the crash in the UAE in summer 1998. The crash in the Kuwait financial markets should have been a reason for moving forward the plan to establish a regulated market, rather than for delaying it. The financial markets in Kuwait were influential in the UAE economy, since there had been UAE investment in Kuwait, the leader in the financial market of the Gulf countries. Furthermore, the Kuwait Securities Market is based in a neighbouring country that has a similar socio-economic background and similar characteristics to the UAE.

Financial market regulation in different countries has mainly been triggered by financial crises. Authorities in all countries should assess the experience of recognized financial regimes to introduce an investment policy based on sufficient regulation and competent authority. In detailed discussions of the experiences of other countries there are two important principles.¹²¹ First, financial market regulation in any country reflects the economic priorities of that country. The financial policy should take into consideration the economic and human resources of the country. For example, the economic priorities of a wealthy country with a small population similar to the UAE are the distribution of its wealth. In this regard, the characteristics of wealth and population in the UAE are very similar to those of Kuwait. Secondly, studies should aim to find how to advance the regulatory system of the country to reduce any systematic risk. There should be evaluation and improvement of the country's financial system and regulations. In the UAE it can be said that a large volume of individuals' wealth traces a limited number of investment opportunities. As mentioned above, this has resulted in over-investment in financial markets. This leads to the proposition that in a country similar to the UAE financial markets constitute important investment revenue. It follows that the authorities should pay consideration to providing markets with rigorous regulation to protect investors and their

¹²⁰ INTERNATIONAL MONETARY FUND, United Arab Emirates: Financial System Stability Assessment, including reports on the Observation of Standards and Codes on the following topics: Monetary and Financial Policy Transparency, Banking Supervision and Payment Systems. (Washington, D.C.: International Monetary Fund, 2003).

¹²¹ Osama Al Ansari, Developments and Future Trends in the Kuwait Financial Market (Translation from Arabic).

أسامة الأنصاري، التطورات الحديثة والتوجهات المستقبلية في السوق المالية الكويتية، في: أسواق المال العربية، واقعها ومجالات تطويرها، مؤتمر عقد في أبوظبي في ١٩٨٤. ص ١٣٣.

investments. Providing a transparent market, which will provide essential investment revenue for wealthy individuals, corporations and public institutions, is essential to the UAE. In this respect, it is recognised that financial markets are important to the economic development of the country. It remains true that the transparency and efficiency of the markets determine whether they aid or hinder economic development.¹²²

¹²² DEVINDER K. GANDHI, ANTHONY SAUNDERS AND RICHARD S. WOODWARD 'Thin Capital Markets: A Case Study of the Kuwaiti Stock Market' (1980) 12 *Applied Economics* 341.

The launch of formal financial markets

In 2000 His Highness the UAE President issued Federal Law No.4 of 2000 to set up a public competent authority to regulate financial markets. This was the “Securities and Commodities Authority” (SCA). The new formal market regime was a turning point in the financial sector in the UAE. Following the set-up of the SCA, formally regulated financial markets were introduced. The Ruler of Dubai issued Decree No.14 of 2000 for the Establishment of the Dubai Financial Market (DFM). This market was established as the first formal financial market in the UAE, and had certain objectives, the most important of which was to create a fair, efficient and transparent marketplace that served the interests of investors and the national economy. The DFM aimed to regulate the process of trading in securities in a manner that protected the interests of investors from unfair and improper practices.¹²³ The Ruler of Abu Dhabi issued Law No. 3 of 2000 Concerning the Establishment of the Abu Dhabi Securities Market (ADSM) as the second formal market in the UAE. This market was aimed at regulating securities transactions in a manner that ensured market transparency, fairness and quality service.¹²⁴ The authorities in Dubai took a further step in initiating financial markets: the Dubai Multi Commodities Centre (DMCC) was created to establish a commodity market place in Dubai. Under the DMCC, it was planned to establish a market infrastructure, technology and a full range of facilities for gold and precious metals, diamonds and precious stones, and energy and other commodities industries. The centre was launched in 2002 as a strategic initiative to provide an investment venue through new markets. The objectives of the DMCC included the initiation of a dedicated market place for commodities in Dubai. The Dubai Gold and Commodities Exchange (DGCX) was established in 2005 under DMCC. An international commodities derivatives market, the DGCX offered a selection of commodities commencing with gold futures.

The most important national markets are the two stock markets of Abu Dhabi and Dubai. The year 2000 saw the launch of the two predominant formal financial markets in the UAE. Years of delays and speculation were ended by the establishment of the DFM and ADSM. The authorities were convinced that there would be a movement to halt the deterioration

¹²³ Decree No.14 of 2000 for the Establishment of the Dubai Financial market. Article 4.

¹²⁴ Law No. 3 of 2000 Concerning the Establishment of Abu Dhabi Securities Market.

that caused considerable losses in the UAE over-the-counter market, and consequently investors' withdrawal of their investments. During the years 2000-2001 the new markets showed poor results, but this later proved a temporary trend. Both markets failed to send positive messages during their first years; daily trading volumes on both markets rarely exceeded US\$1m.¹²⁵ The poor results of the first years were due to shaken confidence in the market which could be traced back to the crash of 1998. Then, the speculative bubble in the OTC market attracted a large number of smaller investors, and some of them borrowed to buy shares. The crash of 1998 resulted in a loss of small investors' wealth because the value of their portfolios could not cover their debts. Investors needed more time to return, since they had lost both wealth and confidence.¹²⁶

The trend of the first years proved to be temporary. The financial markets maintained investors' confidence and enhanced the mechanism of trading. This is supported by the results of 2005. It was indicated in the IMF report that:

Capital markets in the U.A.E. have posted strong growth in 2005, driven by ample liquidity, strong macroeconomic growth, low interest rates, and strong corporate performance.¹²⁷

The value and volume of securities traded in both markets in the UAE led the regions capital markets. In 2005, the volume of trading in the DFM and the ADSM increased by 132% and 69% respectively compared to the previous year.¹²⁸ The two markets reached a peak in November 2005. Following this there was a sharp decline, so that by the end of April 2006 the volume of trading in the DMF and ADSM had fallen by about 55% and 40% respectively from their peak in 2005. The decrease was thought to be due to a sharp correction in market prices caused by overvaluation during the year 2005.¹²⁹

The sharp decrease in the two markets sent confusing messages in terms of their volatility and risk assessment. Some attribute the trend to the inconsistency of regulation relating to finance. It is thought that one reason for the sharp correction was investors' liquidation of their positions to fund subscriptions for Initial Public Offerings (IPOs). The over-

¹²⁵ THE ECONOMIST INTELLIGENCE UNIT, Country Profile 2001 United Arab Emirates. p.41.

¹²⁶ *ibid.*, p.41.

¹²⁷ INTERNATIONAL MONETARY FUND, United Arab Emirates: 2006 Article IV Consultation—Staff Report; Staff Statement; Public Information Notice on the Executive Board Discussion; and Statement by the Executive Director for the United Arab Emirates (Washington, D.C.: International Monetary Fund, 2006). p.11.

¹²⁸ INTERNATIONAL MONETARY FUND *loc.cit.*

¹²⁹ INTERNATIONAL MONETARY FUND *loc.cit.*

subscription of IPOs was due to their under-pricing by the Ministry of Economy, which by law sets the price rather than allowing a fair market value.¹³⁰

It is vital to analyze the causes of the sharp correction and volatility in the two financial markets. Regulations and decisions should be developed in the light of the maintenance of market stability. There are major causes of the shortcomings in the two markets. Analysts believe that small investors with wealth from oil-driven public spending created an overpriced market.¹³¹ The vast increase was also attributed to oil price rises, low interest rates and Gulf investors' preference for domestic markets. However, individual investors constituted the majority in the two markets in the UAE. These markets had built their trades largely on sentiment, causing uncertainty in the markets.¹³²

This brings into question the efficiency of the two local financial markets in the UAE. This question was unwelcome to investors when there were sharp increases, because whether the securities were over-priced or not everyone was benefiting. There was some evidence of a bubble in the securities markets of the UAE in 2005. Although surveys were meagre (in itself this was a problem) but when available they gave adequate warning. The third HSBC-MEED Middle East Business Confidence Survey (MEBCS) makes interesting reading. In this survey, 740 business leaders were asked questions about the current valuation of their domestic economies. In the UAE 50% of the panel thought that the financial markets were over-priced and that there was a bubble. In fact, it is thought that there was a bubble, but for several reasons such a situation was thought to be justified. The high oil prices and production level of the country provided confidence for the economy to move ahead. As a result, there were high expectations of corporate growth and earnings.¹³³

A financial market bubble was a consequence of a complex of economic factors. For the purposes of this study it is important to ask whether the level of disclosure and abnormal activities such as insider dealing contributed to inefficiency in the financial markets. It was believed that the UAE markets were not clean and that market abuse and insider dealing contributed to market inefficiency. In the Dubai Financial Markets, the securities of Emaar

¹³⁰ INTERNATIONAL MONETARY FUND op.cit.

¹³¹ STEVE NEGUS, 'After the growth, Dubai exchange aims to fill trading void' *Financial Times*, February 22 2006.

¹³² STEVE NEGUS loc.cit.

¹³³ TOM EVERETT-HEATH (2005). *Keeping an eye on the bubble*, (URL) <<http://www.meed.com>>, accessed on 4/6/2007.

PLC dominated the market, even though it was thought that “Trading in Emaar has often been controversial, with allegations of insider trading in 2006 when an unexpected withdrawal of bonus shares was preceded by a 4.5% fall in the stock price. Since 2005, Emaar’s stock price has fallen from around Dh50 (\$14) a share to around Dh10”.¹³⁴ In fact, the UAE markets were launched without taking into consideration a high standard of regulation to sustain their efficiency. There are meagre scientific grounds to support this. An important paper by Jay Squalli¹³⁵ aimed to test for market efficiency in the DFM and ADSM, using daily indices between 2000 and 2005. As the UAE embraced an open economy policy and assumed international financial standards, it needed highly structured financial markets. It was important, therefore, that the financial markets operated efficiently. The paper suggested that there was high market volatility and a potential bubble.¹³⁶ The concern was that if market prices were consistently rising before going down, there could be a sharp correction which would result in heavy losses or even a market crash. In fact, the estimated sharp correction occurred during the year 2006 and was combined with heavy losses. As was mentioned previously, there could be a series of causes of a bubble. It is important for this argument if a regulatory shortcoming is one of them. The paper recommended the authorities to take a leading role in regulating abnormal financial activities. It stated: “In the meantime, an inefficient Bull market could suffer overinflated stock prices, speculation and insider trading, all potentially intensified by herding behaviour”¹³⁷ The paper also recommended complete transparency in corporate financial reporting and the adoption of legislation consistent with international standards.

It is logical to raise the question of the extent to which the recent regulation has been practical in solving inherited problems in the UAE markets. This is especially so in the areas which have long been considered weakly regulated, such as limited investor protection, the absence of insider dealing laws and disclosure requirements.¹³⁸ Officials have to face this question if they are serious in their agenda of promoting the country’s markets and economy.

¹³⁴ CROMPTON, SIMON ‘Built on Shifting Sands’ (2007) 26 *International Financial Law Review* 54.

¹³⁵ JAY SQUALLI ‘Are the UAE Financial Markets Efficient?’ in *Working Paper Series, Working Paper No. 05-01* (Abu Dhabi: Zayed University, 2005).

¹³⁶ *ibid.*, p.14.

¹³⁷ *ibid.*, p.14. Full reference here

¹³⁸ MICHAEL REDDY ‘Emerging Markets of the Gulf: An Overview’ (1995) 10 *Journal of International Banking Law* 191. pp.193-4.

One trend which is noticeable in the UAE markets is that they are dominated by individual investors. The law permits four sectors to hold shares in the UAE companies. These are: individuals, companies, governmental institutions and other sectors. In relation to the securities listed in the Abu Dhabi Securities Market, statistics show that in 2001, individuals owned more than 61% of the total number of securities. In terms of the volume of securities individuals owned about 43% of the volume of the listed securities.¹³⁹ Therefore, a large percentage of the investors in the UAE markets are thought to be individual short-term speculators. Individual investors' dependence on sentiment and herding to make their investment decisions resulted in a volatile market. The current situation of individual investor domination is detrimental to the market in terms of volatility and risk. The authorities in the UAE should work to attract institutional investment into the markets. For the purpose of this thesis, the question that should be asked is: what measures have been adopted to protect individual investors and to maintain a system of equal access to inside information? If this task is not achieved by the current regulation, the efficiency and informativeness of the market will be questioned. Underscore in the efficiency of financial markets may result in negative effects on the rest of the country's economy, as happened in 1998.

Shortfall in the enforcement of the timely disclosure and insider dealing regulation

The problem of underachievement in enforcing the disclosure regulation following the establishment of the formal system is obvious. The promulgation of the laws establishing the SCA and the markets, and the regulations introduced by the SCA have not represented an efficient device for reaching the required transparency. The specific difficulty has been in the departure from the old corrupt situation where public corporations did not disclose material information but rather such information was the monopoly of directors, executives and their acquaintances. It is thought that the problem of monopolising and concealing material information from shareholders and investors has not been solved. There is no evidence that the current regulation of insider dealing has been a deterrent to insiders dealing on the basis of inside information and making investment decisions ahead of other investors. Insiders can use inside information for their personal benefit by dealing in the

¹³⁹ Addi Qasior, Protection of Individual Shareholder's Rights in Abu Dhabi Securities Market (Translated from Arabic).

عدي قاصيور حماية حقوق المساهمين الأفراد في سوق أبوظبي للأوراق المالية (أبوظبي: مركز الإمارات للدراسات والبحوث الاستراتيجية، ٢٠٠٥). ص ٣٠.

related securities and making a profit or avoiding a loss. In a business atmosphere where insiders exploit their powers to delay disclosure, the shortfall in disclosure and the concealment of information is detrimental to the market and investors. In the absence of a high level of transparency and disclosure, the emergent markets in the UAE depend on rumours. This means a high degree of systematic risk, market inefficiency and investor losses because decisions are made on the basis of incomplete information. It is a common situation in an emergent market, but this is not to propose that it cannot be faced by the authorities. The timely disclosure system should be stringently enforced in order to maintain a fair market for all investors. This should result in a more efficient and informed market. The aim of the disclosure system should be clearly determined: that is, the dissemination of all the material information into the market to enable investors to make informed investment decisions. Investors direct their investment to transparent markets in which the obligatory disclosure system ensures that they are put on an equal footing in terms of information. If insiders are not deterred from exploiting their positions and concealing and monopolising material non-public information, it does not auger well for transparent markets which benefit the economy of the country. It is on this line of reasoning that the SCA should have a stringent attitude towards enforcing the rules relating to insider dealing and timely disclosure. The SCA is required to take the necessary measures and procedures to maintain investors' rights of equal access to information. It is also required to deter insider dealing and to raise the level of transparency closer to international standards. In this regard, the SCA should have introduced its policy for enforcing the regulations. However, the fact is that the SCA seems to be lenient on breaches and its warnings do not amount to more than a slap on the wrist. In UAE markets there is still no rigorous enforcement of the regulations. Some justify this by claiming that these markets are emergent. Nevertheless, this does not provide an answer to why unclear rules were dedicated to the complicated problem of insider dealing. Also, it does not explain why the authorities in the UAE have not adopted a clear policy for reform.¹⁴⁰

Timely disclosure as a system was not known in the UAE before the establishment of the SCA and formal markets. The public corporations were only subjected to annual and quarterly disclosure under the Federal Company Law Number 8 of 1984. One problem with the timely disclosure system is that the related rules are unclear. This is a common problem

¹⁴⁰ For a discussion see ROBERT DITCHAM (31/3/2007) Lack of disclosure causing market instability. *Gulf News* and GAURAV GHOSE (27/3/2007) DFSA chief calls for transparency. *Gulf News*.

in the Regulations as to Disclosure and Transparency promulgated by the Securities and Commodities Authority.¹⁴¹ The other problem is that the SCA has not been stringent and transparent in enforcing the timely disclosure rules. The SCA should have concentrated on the timely disclosure system at least to the extent it has concentrated on the quarterly disclosure system.

Investment professionals still think that issuers have to disclose more information in order to direct share prices to be fairer. This is essential in order to maintain an efficient market. This call came following warnings from the SCA to issuers who did not meet the deadline for disclosing quarterly results. If we agree that quarterly disclosure was a basic and very straight-forward obligation on public companies even before the establishment of the SCA, it is difficult to see how issuers will comply with an advanced timely disclosure system, when they still do not meet the basic requirements of quarterly disclosure. It is thought that in the UAE financial markets, when predicting an issuer's position, analysts face scarcity of information. It seems that issuers do not disclose adequate timely information. There is demand for substantial reform of corporate governance, specifically in relation to disclosure requirements. The disclosure system is emergent, which means that UAE local markets are still prone to systematic risks because share prices do not necessarily reflect inside information. An effective system of disclosure of information is the most important method of disseminating important information into the market.¹⁴²

The question then is: what constitutes a practical method to compel issuers to disclose information? It was seen that when the SCA implemented more rigid controls on issuers by imposing fines on companies, the disclosure of quarterly results improved. The proportion of issuers complying with the schedule and disclosing quarterly results improved significantly from the beginning of 2006. This was due to the SCA threat of imposing fines for failure to meet deadlines to publish quarterly results. On average, 75% to 80% of the issuers published their quarterly results within the 30-day period in the first half of 2006. In the first half of 2005 only 60% to 70% of the issuers published within the same deadline.¹⁴³

It can be said that it is a basic obligation for issuers to disclose the quarterly results. In other words, it cannot be considered an achievement when issuers do disclose their quarterly

¹⁴¹ See below heading: Insider dealing regulation in local financial markets in the UAE.

¹⁴² ARIF SHARIF (8/8/2006) Call for better corporate disclosure rings in the UAE. *Gulf News*.

¹⁴³ ANONYMOUS (17/10/2006) TNI says tighter UAE market control is improving disclosure habits, but data is inconsistency. *The National Investor*.

results. The SCA has been successful in enforcing this obligation. However, the SCA's announcement that the percentage of issuer disclosure of quarterly results in the first quarter of 2007 was 100% can be regarded as misleading propaganda. It is true that this was the first time since formal markets were established that all the issuers disclosed their quarterly results within the legal deadline.¹⁴⁴ The SCA announcement would be considered as misleading if it was in any other developed system. This does not help solve the underachievement in disclosure in an emergent market. It is clear that the SCA has not answered the crucial question regarding whether issuers meet their obligation of timely disclosure of inside information. The SCA, apparently, has not introduced a realistic method to measure issuers' meeting their obligation of timely disclosure.

¹⁴⁴ Albayan (20/5/2007) (A newspaper issued in Arabic UAE).

البيان (٢٠٠٧/٥/٢٠) هيئة الأوراق تعلن ارتفاع نسب إفصاح الشركات المساهمية إلى ١٠٠%. البيان.

The law of securities markets in the UAE

The transmission from informal to formal securities markets was properly represented in promulgating the law establishing the markets and the regulatory authority. First of all, Federal Law No.4 of 2000 Concerning the Emirates Securities and Commodities Authority and Market was adopted. Federal Law No.4 of 2000 constituted the premise for establishing formal local securities and commodities markets and the establishment of the Securities and Commodities Authority as the regulatory body. Article (2) of Federal Law No.4 of 2000 states:

A public authority with the name of the “Securities & Commodities Authority” shall be established in the State’s capital. It shall enjoy juristic personality and financial and administrative independence, and shall have the supervisory and executive powers necessary to perform its functions according to the provisions of this law and the regulations issued in implementation thereof. It shall be adjunct to the Minister.

In Article (3), Federal Law No.4 of 2000 determines general objectives for establishing the authority. It states:

The Authority shall have as its purpose the achieving of the following objects:

- 1 - To provide the opportunity to invest savings and funds in Securities and Commodities in a manner that serves the interest of the national economy, secures the integrity and accuracy of transactions, ensures interaction of the forces of supply and demand in order to determine prices and protection of investors by establishing the bases for sound and just dealings between the various investors.
- 2 - To develop investment awareness by conducting studies and presenting recommendations.
- 3 - To work to secure financial and economic stability.

Federal Law No.4 of 2000 also grants the Securities and Commodities Authority the necessary powers to achieve its objectives. The most important is empowering it to promulgate and enforce regulations. Article (4) determines the areas which can be regulated by the authority and the procedure for adopting such regulations. It states:

First: In the achieving of its objects, the Authority may exercise the following powers:

- (1) To propose the regulations as to the following, to be issued by resolution of the Council of Ministers:

- (a) Regulations concerning its functioning.
- (b) Regulations concerning the licensing and monitoring of the Market.
- (c) Regulations concerning the acceptance, listing, and canceling or suspending the listing of any Securities or Commodities from being traded in the Market.

(2) To make the following regulations, in consultation and coordination with the Markets licensed in the State:

- (a) Regulations concerning the functioning of the Market.
- (b) Regulations concerning Brokers and the regulating of their functions and the cessation thereof.
- (c) Regulations concerning trading, clearances, settlement, transfer of ownership and custody of Securities.
- (d) Regulations concerning membership of the Market.
- (e) Regulations concerning disclosure and transparency.
- (f) Arbitration regulations in disputes arising from trading in securities and commodities.

(3) To form specialist technical committees, and to specify the scope of their work and the remuneration therefore.

(4) To be in contact with international markets in order to obtain and exchange information and know-how, and to join relevant Arab and international organizations and federations.

(5) To perform all other acts which assist the achieving of the Authority's objects or the exercise of its powers pursuant to the law.

Second: Markets licensed in the State may propose amendments they deem appropriate to the regulations provided for in this Article.

The initial impressions of the Federal Law No.4 of 2000 were positive in sense that it introduces an authority which has legal capacity and financial and administrative independence. The Securities and Commodities Authority was initiated to form the

competent authority promulgating regulations governing wide areas. More specifically, there was explicit empowerment of the authority to:¹⁴⁵

- adopt and enforce the necessary rules to regulate brokers;
- accept and list the securities and commodities to be traded on the markets;
- regulate the trading;
- oversee the clearance and transfer of the ownership of securities;
- establish a control system for the markets; establish an arbitration regime that would settle disputes arising from the trading of securities and commodities;
- form specialised technical committees to cancel or suspend trading in securities or commodities in order to protect investors;
- and temporarily suspend brokers or cancel licenses issued to them or to companies listed on the markets.

Nevertheless, this does not mean that the fundamental responsibilities were clearly determined. On the contrary, in a very vital area such as disclosure, it was not clear from the beginning whether it would be the competence of the board of directors of the market or the SCA.¹⁴⁶

To ensure that the SCA was empowered to issue and enforce regulations, Federal Law No.4 of 2000 dedicated Chapter Two to ‘The Organs of the Authority and their Competences’. Article (6) of the Federal Law No.4 of 2000 states that:

The Authority shall be administered by a board of directors formed by resolution of the Council of Ministers having as Chairman the Minister and as members:

- 1 - Two members representing the Ministry,
- 2 - Two members representing the Ministry of Finance & Industry,
- 3 - One member representing the Central Bank, and
- 4 - Four members being persons of experience and competence nominated by the Minister, in coordination with the Minister of Finance & Industry.

The competences of the board of the SCA are determined in Article (12) which states:

¹⁴⁵ CHARLES S. LAUBACH ‘UAE: Stock Market Law’ (1999) 1 *Journal of International Financial Markets* 28. p.28.

¹⁴⁶ JOHN G. RIDDICK ‘UAE: Official Stock Market’ (1999) 10 *International Company and Commercial Law Review* 39. pp.39-40.

The Board of Directors shall exercise the following competences:

- 1 - To ensure that the regulations mentioned in Article 4 of this Law are applied.
- 2 - To receive notifications and complaints relating to the activity of the Market or Brokers and take appropriate resolutions thereon according to the provisions of this Law and the regulations issued pursuant thereto.
- 3 - To require the Market and Brokers to submit balance sheets, profit and loss accounts, and annual financial statements audited by an accredited auditor, within one month following the end of the financial year.
- 4 - To require the Market to take the necessary measures for disclosure by the companies whose Securities are listed therein of any substantial developments occurring in such companies.
- 5 - To ensure transparency and disclosure as prescribed in this Law and the resolutions implementing it.
- 6- To issue the requisite resolutions concerning approval of membership of the Market and trading in securities and commodities in accordance with the provisions of this Law and the regulations issued pursuant thereto.
- 7 - To undertake all other acts which assist the Board in achieving the objective of the Authority.

In the year 2000, the UAE Federal Cabinet issued three Resolutions in implementation of Federal Law No. 4 of 2000 Concerning the Emirates Securities and Commodities Authority and Market. These three Cabinet Resolutions are: Cabinet Resolution No.11 the Regulations as to Market Licensing and Supervision; Cabinet Resolution No.12 the Regulations as to the Listing of Securities and Commodities; and Cabinet Resolution No.13 the Regulations as to the Functioning of the Securities and Commodities Authority.¹⁴⁷

Cabinet Resolution No.13 contains important provisions in regard to the mechanism of regulating financial markets through the SCA. It ascertains the objectives of the SCA and delegates it the necessary powers to supervise and control the operation of securities commodities markets in the UAE. There is apparently repetition in determining the objectives of the SCA; these had already been mentioned in Federal Law No. 4 of 2000. However, this Resolution indicates important objectives of the SCA. The targeted

¹⁴⁷ ANTHONY WATSON 'United Arab Emirates: Federal Securities Regulations' (2001) 3 *Journal of International Financial Markets* 29. p.29; and CHARLES S. LAUBACH AND AMJAD A. KHAN 'United Arab Emirates: Securities and Commodities Market' (2000) 2 *Journal of International Financial Markets* 40.

objectives seem to be close to those set by the international principles of securities regulation. Thus, it can be said that the law determined ambitious objectives for the SCA. Whether the system has been stringent in achieving these objectives or not is another issue. Article (7) of the Cabinet Resolution indicates that the SCA shall have as its purpose the achieving of the following objects: 1) To provide a suitable climate for the investment of savings and funds in securities and commodities in a manner that serves the interest of the national economy, secures integrity of transactions and protects investors. 2) To work to secure financial and economic stability. 3) To protect holders of securities, investors and the public in a manner that secures integrity and accuracy of transactions. 4) To regulate, develop and monitor the securities and commodities markets. 5) To develop investment awareness by conducting studies and presenting recommendations.

Cabinet Resolution No.13 also authorizes the SCA to regulate the listing of securities and commodities, to determine the fees required, to regulate brokers, and to organize and control the disclosure of information regarding securities. It is empowered to conduct all other functions to carry out its objectives.¹⁴⁸ In particular, Article (8) of Cabinet Resolution No.13 delegates powers to the SCA. There is repetition in mentioning the powers, since Article (4) of Federal Law No.4 of 2000 mentioned the powers of the SCA. In turn, this article repeats the above-mentioned powers. It indicates that in the achieving of its objects, the SCA has the power: 1) To propose and make regulations as provided for in the Law. 2) To supervise and monitor the functioning of the markets. 3) To license markets and brokers and authorize the listing of securities and commodities for trading in the market. 4) To determine, in consultation with the markets, the fees charged in order to implement the provisions of the Law and the regulations issued pursuant thereto. 5) To remove brokers from the registers of the brokers licensed in the market. 6) To regulate and monitor the disclosure of information relating to securities. 7) To form specialist technical committees and to specify the scope of their work and the remuneration thereof.

Cabinet Resolution No.13 also determined the main organs of the SCA and their competences. There is also apparent repetition in determining the organs of the SCA and their competences, since Federal Law No.4 of 2000 had already achieved this task. Article

¹⁴⁸ ANTHONY WATSON 'United Arab Emirates: Federal Securities Regulations' (2001) 3 *Journal of International Financial Markets* 29. p.32; and ANTHONY WATSON 'United Arab Emirates: Brokers Regulations' (2001) 3 *Journal of International Financial Markets* 33. p.35.

(11) of Cabinet Resolution No.13 provides for “10” competences of the board of directors of the SCA. One essential competence is to take receipt of information laid and complaints made relating to the market or to brokers, and to take the appropriate decisions thereon, including the ordering of investigations to be made and the imposing of penalties in accordance with the provisions of the Law and the regulations issued pursuant thereto.

The establishment of the SCA aimed to avoid the vacuum which formerly existed, and which caused uncertainty in the marketplace in the period of the informal unregulated market. In general, it can be said that the SCA is a statutory regulating authority. Federal laws delegated powers to the SCA, appointed its administrative bodies and outlined its objectives. The SCA is supposed to regulate financial services in the Abu Dhabi Securities Market (ADSM) the Dubai Financial Market (DFM) and the Dubai Gold and Commodities Exchange (DGCX). However, certain basic issues remain unclear. One significant source of deficit which can be easily identified when looking at Federal Law No.4 of 2000 and the implementing Cabinet Resolutions, is the repetition of the objectives and powers of the SCA. The Cabinet should have promulgated detailed regulation to implement the Federal Law rather than repeating similar provisions. It is apparent that at this stage there were no rigorous studies of comparative laws and regulations. The result has been the establishment of a regulator which is not adequately empowered by the law to achieve its objectives. This is especially so taking into account that the aim was to provide a suitable climate for the investment in a manner that served the interests of the national economy, secured the integrity of transactions and protected investors. In specific terms, there appears to be a need for more powers delegated to the SCA in relation to the supervision, investigation and enforcement of the regulation.

Although the competences of the SCA are repeated and the powers thereon are not specified, an important competence which may be uncommon for an emergent regulator was introduced. This is in Article (11) of Cabinet Resolution No.13, which empowers the SCA to handle complaints made relating to the market or to brokers and take the appropriate decisions thereon, including the ordering of investigations to be made and the imposition of penalties. In fact, imposing of penalties is an important weapon, and is seen as the most important competence of a modern regulator. There are demands to further the SCA powers in this area. There are calls to delegate judicial powers to the SCA to probe

and investigate crimes relating to the financial and stock market sectors. Financial crimes should be faced by a sophisticated unit, which has sufficient delegated powers to investigate crimes of a complicated nature. Legal and stock exchange experts have called for combating financial market crimes to protect the markets of the country. There are threats that criminal elements, who can misuse and manipulate the markets for their own benefit, can endanger the financial system. It is thought that it is time to protect financial markets and the interests of investors. An important method of achieving this is thought to be the enhancement of the capabilities of the regulator to detect effectively and investigate highly sophisticated crimes.¹⁴⁹

An area which is not clearly determined by the law is the separation of the powers of the SCA from those of the markets. The ADSM and DFM still have powers in relation to the listing of securities. They also have authority for handling the entrance of brokers and the listing of securities in the markets. They set listing standards and accept listings of securities. The problem is that the law has not specifically delegated powers to the markets. The regulatory powers of the SCA and the stock markets are not clearly defined in law. In this situation, it is not clear whether the continuous obligations of the listed company are owed to the market, or to the authority, or both. Also, the requirements for listing securities are not comprehensively determined in the law. This may result in listing securities of issuers that are not viable in terms of compliance to an acceptable level of disclosure and transparency. In practice, the bureaucratic arrangements and administrative decisions are used as alternatives in areas which are not determined by the law. This is another area in which the board of directors of the SCA needs to reach temporary decisions to distinguish between the powers of the markets and those of the SCA.¹⁵⁰ However, the problem remains that the authority to accept listing being in the hand of the markets means that the SCA has less control over issuers.

Another problem is that financial services in the UAE are regulated by a number of authorities. In fact, the UAE does not have a single financial services regulator. The Central Bank of Union (CBU) is the regulator responsible for regulating banking and investment business. It is therefore responsible for licensing and authorising financial intermediaries

¹⁴⁹ SCA NEWS *Call to give powers to SCA to check crimes*, 21/3/2005.

¹⁵⁰ Albayan (12/3/2006) (A newspaper issued in Arabic UAE).

البيان (٢٠٠٦/٣/١٢) تعديلات على قانون تأسيس هيئة الأوراق المالية تتناسب مع المرحلة المقبلة. البيان.

and investment companies. The CBU authorities are determined by Federal Law No. 10 of 1980, Concerning the Central Bank, the Monetary System and Organisation of Banking. The CBU is empowered to promulgate regulations to govern areas within its authority. However, in relation to the regulation of financial services, the CBU has not developed its traditional functions. One example is that it has not introduced a system of publishing all the regulations to the public.¹⁵¹ The Ministry of Economy is in charge of implementing company law and corporate governance provisions. It supervises the promotion of corporations and regulates Initial Public Offerings (IPOs). It also regulates insurance business. One shortcoming in financial services regulation, which is apparent in the SCA, CBU and Ministry of Economy, is that in many areas the promulgated regulations are not sufficiently detailed.¹⁵²

The SCA was established in 2000 to act as the supervisory authority over the financial markets. However, the point which was not considered was the overlap between the responsibilities of the two formerly existing authorities and the SCA. The powers of the authorities engaged in financial services regulation need to be clearly defined, in particular more powers should be delegated to the SCA.¹⁵³ Compared to the CBU and the Ministry of Economy, the SCA is a more modern authority. When there was a transition from informal to formal financial markets, there should have been a delegation of the necessary powers from the CBU and Ministry of Economy to the SCA. In order to maintain a sound regulatory system, the SCA should have been specifically delegated the powers of licensing and supervising financial intermediaries and investment companies, and of supervising IPOs.

The Ministry of Economy does not have a clear policy towards financial markets. It acted with shortcomings with regards to promotions and IPOs which are connected to a sound secondary market. In particular, the Minister of Economy restricted the growth of the markets by requiring that all public offerings should include a minimum of 55% of the company's shares. This requirement has discouraged the floating of many family-owned corporations. As a solution, the Federal National Council has promulgated an amendment

¹⁵¹ See ANDREW HENDERSON AND ANTONY HAINSWORTH 'Financial Regulation in the UAE' (2007) 26 *International Financial Law Review* 12.

¹⁵² *ibid.*

¹⁵³ INTERNATIONAL MONETARY FUND, United Arab Emirates: 2006 Article IV Consultation—Staff Report; Staff Statement; Public Information Notice on the Executive Board Discussion; and Statement by the Executive Director for the United Arab Emirates (Washington, D.C.: International Monetary Fund, 2006). p.39.

to Federal Company Law No. 8 of 1984. The amendment allows a minimum listing of 30% of the company shares. This is expected to encourage floating of family-owned companies because it allows the family to retain control over the company.¹⁵⁴ Another area which has also been criticized is the Ministry of Economy's pricing of IPOs. The Ministry ignored fair pricing of the shares through the market powers of supply and demand, and adopted a scale of one share equals one Dh. By under-pricing the issued securities to Dh 1, the Ministry of Economy encouraged a huge oversubscription. This meant that there was a substantial liquidation of shares in the secondary market, a fact which resulted in a sharp market decline in the year 2006.¹⁵⁵ To resolve this problem, the Ministerial Council of Services, in its Decision No. 3/3 of 2007, transferred the authority to supervise the prospectus for public offers from the Ministry of Economy to the SCA.¹⁵⁶ The problem remains that this is a cosmetic change. The government has not promulgated the law governing public offers and IPOs.

Another area which seems to be unsound is the relationship between the SCA and the CBU.¹⁵⁷ It was not until the end of the year 2006, that Federal Law No. 10 of 1980, Concerning the Central Bank, the Monetary System and Organisation of Banking was amended to transfer the authority to register and supervise brokers from the CBU to the SCA.¹⁵⁸ This transfer of authority is expected to give the SCA more powers to supervise trading in the markets. However, it should also be said that this is a cosmetic change. There is still neither a clear policy nor a comprehensive body of law for registering and supervising the various financial services institutions; for example, financial intermediaries, investment banks and investment consultation services.

Insider dealing regulation in local financial markets in the UAE

Insider dealing regulation in local financial markets in the UAE consists of three articles under the Regulations as to Disclosure and Transparency promulgated by the Securities and Commodities Authority. These three articles are:

Article (37):

¹⁵⁴ See CROMPTON, SIMON 'Built on Shifting Sands' (2007) 26 *International Financial Law Review* 54.

¹⁵⁵ PETER J. COOPER (2006) *IPOs in the UAE: Surely there has to be a better way*, (URL) < <http://www.ameinfo.com/80980.html> >, accessed on 11/12/2007.

¹⁵⁶ Ministerial Council of Services, Decision No. 3/3 of 2007. 2/5/2007.

¹⁵⁷ CROMPTON, SIMON 'Built on Shifting Sands' (2007) 26 *International Financial Law Review* 54.

¹⁵⁸ Abdulfattah Montaser, Transferring Authorities from Central Bank to the SCA, *Albayan* (12/3/2006) (A newspaper issued in Arabic, UAE).

عبدالفتاح منتصر (٢٠٠٦/١١/٣٠) نقل صلاحية الترخيص والإشراف على الوسطاء من "المركزي" إلى هيئة الأوراق. البيان.

Pursuant to Federal Law No. 4 of 2000 concerning the Emirates Securities & Commodities Authority and Market, any person shall be liable to imprisonment for a period of not less than three months and not more than three years and a fine of not less than one hundred thousand (100,000) Dirhams and not more than one million (1,000,000) Dirhams, or either of these penalties, if he:

1. Furnishes any data, or proffers any declaration or information being untrue and such as to affect the market value of the securities and an investor's decision to invest or otherwise.
2. Deals in securities on the basis of unpublicised or undisclosed information he acquired by virtue of his position.
3. Spreads tendentious rumours regarding the selling or buying of shares.
4. Exploits unpublicised information which could affect the prices of securities to achieve personal benefits.

Any dealing or transaction effected on the basis of the preceding shall be null and void.

Article (38):

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

Article (39):

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

Preliminary Observations on the three Articles:

It is appalling that such poorly drafted articles are designed to deal with such a complex act as insider dealing. It appears that no constructive criticism will suffice and no cosmetic changes to these articles will work. The matter is compounded by introducing criminal offences while the law sets no clear definition of the punishable act.

According to Article (37) a person may face imprisonment for three years or a fine of one million Dirhams for acts unclearly defined by the law. Article (37) Para (2) makes it an offence for a “person” to deal in securities on the basis of “unpublicised” or “undisclosed”

information he acquired by “virtue of his position”. In addition, Article (37) Para (4) makes it an offence for a “person” to “exploit” “unpublicised information” which “could affect the prices of securities” “to achieve personal benefits”. However, the drafters of the article did not introduce any definition or guides as to the necessary terms.

What is the definition of “person”? Is he only a natural person? Is he a legal person, for example a company, liable under this article?

What is the definition of “unpublicised” or “undisclosed” information? The two terms are not synonymous, since “or” means that fulfilling one criterion is sufficient. Neither of the terms is defined or brought under guidelines. The drafting of the articles pays no consideration to any of the complicated situations which may be faced in defining “inside information”. The two terms are rather strange, and cannot be compared to the definition of “inside information” in recognized jurisdiction in order to reach a reasonable definition.

What is meant by “by virtue of his position”? Are directors only liable? What about employees and people who have access to information because of their profession, for example lawyers and accountants?

Article (37) Para (4) also provides no definition of “exploits” and “unpublicised information”. It should be clear what actions comprise “exploitation”, for example disclosing the information to a third party or inducing him to trade on the basis of the information. It is bizarre that the drafters remembered in this paragraph to state that the information “could affect the prices of securities”. It is also inexplicable why there must be a personal benefit. Insiders may seek indirect benefits by establishing networks to exchange inside information.

Article (39) is clearer in determining liable insiders. It provides a list of primary insiders. These are the chairman, the members of the board of directors, the general manager and any of the employees of the company as insiders. The drafters were not even capable of introducing a viable term for the institution to which insiders belong. They used “of a company whose securities are listed in the Market”, a sentence which could easily be replaced by the more precise term “issuer”. The last term should also be brought under clear definition. This article also utilizes the term “inside information”. This is another example of ambiguity, since in three articles three different terms are used for the same thing. Another shortcoming of the article is that of the scope of the prohibition. It only prohibits exploiting inside information by dealing in securities. Disclosing such information to a third party, for example, is not prohibited under this article.

It is apparent without even studying the provisions of these articles in detail that this law is poorly drafted. The three articles are drafted without taking into account basic legal principles to be observed in codification. The gross deficits do not appear to be capable of correction by cosmetic changes.

The regulation of timely disclosure in the UAE

The regulation of timely disclosure in local financial markets in the UAE consists of three articles under the Regulations as to Disclosure and Transparency promulgated by the Securities and Commodities Authority. These three articles are:

Article (33):

The company or entity whose securities have been listed in the Market shall notify the Authority and the management of the Market of any significant developments affecting the prices of such securities upon learning of the same, such as catastrophes, fires, mergers, the issue of new securities, the discontinuance of a production line, voluntary liquidation or lawsuits filed by or against the company affecting its financial position.

The board of directors of the Market shall have the right to publish any statement in respect of such developments in the local press and other media it deems appropriate.

Article (34):

A company or entity whose securities have been listed in the Market shall, when so requested, publish any explanatory information which relates to its circumstances and activities and is such as to secure the integrity of transactions and the confidence of investors.

If any change occurs in a significant matter contained in a previously published press announcement, such entity or company shall issue a press announcement reflecting the actual situation after the change, the subsequent press announcement to be issued in the same newspaper or newspapers as contained the earlier announcement.

Article (35):

It shall be permissible for the entity or company not to issue a press announcement regarding any given information, if its senior management has reasonable grounds to believe that the revealing of such information will lead to serious damage to its interests, and there has not been, nor will be, any dealing in its shares by members of its board of directors and executive managers and their relatives to the first degree on the basis of the information not announced to the public, provided that the company furnishes to the director of the Market such information and data, requesting him to consider them confidential until the grounds which gave rise to that no longer subsist. The director of the Market may, in coordination with the Authority, accede to such request or compel the company to announce the information and data.

The criticisms of the rules directed to insider dealing seem to be applicable to the rules directed to timely disclosure. It is apparent that the Regulations as to Disclosure and Transparency promulgated by the Securities and Commodities Authority are poorly drafted. Articles (33) and (34) used “the company or entity whose securities have been listed in the Market” to indicate to the “issuer” who is obliged to disclose inside information. Article (33) required the issuer to notify the SCA and the market of “any significant developments affecting the prices of such securities”. In fact, it is unclear whether the effect should be ‘probable’ or ‘definite’. Significant developments may not be represented in the market price of the securities, especially where the related security is a bond. However, the change may affect the value of the issuer or its position. In this article it is not said whether the changes or developments affecting the “value” rather than the market price of the securities should be disclosed. Another shortcoming is that the article does not state clearly the time in which disclosure should be made. Stating that “upon learning of the same” is not clearly determining the reasonable time in which disclosure is required.

Article (33) used some non-exhaustive examples of events in which the issuer should make timely disclosure. This is a positive characteristic of the article, since it provides clarity and guidance for the issuers. Another positive characteristic in this article is giving the market the right to publish any statement in respect of disclosed information.

Article (34) is directed to circumstances in which the issuer is requested, by the market for example, to publish any explanatory information which relates to its circumstances and activities. This article aims at providing a basis for the market to request the issuer to disclose explanatory information. This may be necessary to inform the market and investors, especially when there is a need to answer rumours in the market. However, it would have been proper to clarify when the burden is placed on the issuer to identify the existence of inside information and to disclose it. There is also no mention of the issuer’s liability in relation to “selective disclosure”.

Article (35) provides an exemption where issuers can delay disclosure of information. This exemption is essential to protect the business. However, there is a significant deficit in the article. Where the issuer is allowed not to disclose the information, it should keep it confidential in order to prevent insider dealing activities. This article, however, only

requires that “...there has not been, nor will be, any dealing in its shares by *members of its board of directors and executive managers and their relatives to the first degree....*” This means that there is no clear obligation to protect the information from being used by employees, or from being disclosed to a third party other than relatives to the first degree. This is a gross shortfall which indicates that inside information is not sufficiently protected by the SCA regulations.

One difficulty with studying these provisions is that there is neither legal guidance nor a clear policy adopted by the SCA which may shed light on how the related provisions will be interpreted and enforced. In addition, there has not been any judicial precedent in relation to these provisions which would pave the way for interpretation. Therefore, the only viable method of holistically studying the rules relating to insider dealing in the UAE is to compare them to their equivalent in other jurisdictions.

Conclusion

One main aim of this thesis is to recommend new rules. It is planned to achieve this through the functional comparison in Chapter 5. The recommended rules will be outlined in the final chapter, ‘recommendations’. This chapter has indicated the shortcomings, while the comparative legal study will propose solutions.

This chapter has attempted to provide a background history to the development of financial market regulation in the UAE. The following assumptions can be derived from the discussion in this chapter. The informal unregulated market stage was ended by an economic deterioration which had effects on the rest of the economy of the country. There are clear indications that, in the absence of regulation, insider dealing and other market abuse contributed to the deterioration in 1998. The establishment of the SCA and formal financial markets was a turn-point in the history of regulation. However, the inexperienced regulatory system may have shortfalls in the areas of transparency and protection of the market and investors. It seems that regulations are still very much behind international standards. The conundrum is that the current regulations do not appear to constitute an efficient system which will deter insider dealing and enforce issuers to make timely disclosure. Based on the history of financial markets in the UAE, it is also assumed, that rigorous regulation is the main method in maintaining an informative, transparent and efficient market. Although an attempt was made to support these assumptions throughout

the chapter, it seems proper for the applied study to provide more certainty regarding these hypotheses.

In regards to the deficits in the rules relating to insider dealing, it seems that there should be a fresh construction of new rules. This will be the main task of Chapters 4 and 5. The aim is to recommend a new drafting of these rules. This, however, will be appropriate following the applied study, which investigates the problem and the comparative legal study aimed at providing a solution.

Chapter 3: applied study: opinions and attitudes of investors and other experts on the regulation of insider dealing in the local markets in the UAE

Introduction

Research Methodology

 Research questions

 Hypotheses

 Research methods

 Questionnaire

 Interviews

Results and analysis of the applied study

 The questionnaire

 Interviews

A summary of the results of the applied study

Conclusion

Introduction

This chapter is an applied study which aims at defining the nature of the practical problems related to insider dealing on the ground. It makes a contribution to the discipline of insider dealing by filling the gap caused by a shortage of academic resources in the UAE. The applied study, comprising questionnaire and interviews, provides the grounds for testing hypotheses and supporting the arguments raised in the preceding chapters. In this regard, it will be of great value to consider the attitude of investors and experts as valid indications of the current status of regulation. Applied methodology is a realistic approach to identifying the issues relating to the regulation of insider dealing in the UAE. It should support the theoretical background in the earlier chapter and raise the practical problems relating to insider dealing in the UAE.

This chapter is divided into two main parts. The first deals with the research methodology of the applied study. This section discusses the plan of the study in terms of determining research questions, hypotheses and research methods. The second part of the chapter discusses the results and analysis of the applied study. It provides a representation and brief discussion of the results of both the questionnaire and the interviews. The chapter ends with a summary of the results of the applied study.

Research Methodology

Setting the goal of the thesis as looking at the problem of insider dealing in the UAE from an empirical and comparative law perspective, the aim is to contribute to the body of knowledge in this area. Such a contribution seems to be appropriate if it is made to UAE law, which at present lacks sufficient academic contributions. One way in which we intend to make a contribution is by conducting field research.

This is essential, since there is a shortage of academic resources in UAE insider dealing law and a need for more information to sustain the arguments of the thesis. The applied study aims at identifying the opinions and attitudes of both investors in the UAE local markets and experts in regulation or regulatory bodies. The results of the applied study should be helpful in drawing a clear picture of the current regulatory situation in general, and the regulation of insider dealing in the UAE in particular. It should be noted that it has been decided that the applied study should only be conducted in the UAE. This is because we need to concentrate on making a contribution in an area which has not adequately been covered by studies. The UK and US jurisdictions do not lack studies and research. Another

reason is to save time, effort and money directed to the study by concentrating on one country.

On this basis, this chapter contains a detailed outline of research methodology and the results and analysis of the applied study. It explains the planning of the methodology and methods. It also explains in detail the steps taken in practice to conduct the questionnaire and interviews. Following this, the second half of the chapter is dedicated to the results and analysis of the applied study.

Research questions

The field research must be able to generate important information in regard to the nature of the problem of insider dealing. It must add to our academic understanding in order to answer the thesis questions in the following areas:

What is the extent and nature of insider dealing in real life?

What are its effects on the securities markets?

Should insider dealing be prohibited?

Is UAE law sufficient to prevent insider dealing?

How can the law and regulation be improved to prohibit insider dealing?

Are the rules of the DIFC a good example for reform in local market regulation?

What is the meaning of ‘insider’ and ‘inside information’?

How can the competent authority be empowered to enforce the rules?

What sort of punishment is appropriate to deter insider dealing?

What is the relationship between the rules directed to prohibit insider dealing and those directed to market abuse and timely disclosure?

Hypotheses

The applied study will test the following hypotheses:

1- Primary grounds for regulating insider dealing. Insider dealing should be regulated:

- It is against ‘equality of information’ and is detrimental to market transparency and informativeness.
- To protect investors’ rights and their confidence in the market.
- To meet the call for financial market regulation being moved closer to international standards.

2- Secondary grounds for regulating insider dealing. Insider dealing should be regulated because:

- It is unfair.
 - It has negative effects on the economic efficiency of financial markets.
 - It has negative effects on the economy of the country.
 - It has negative effects on attracting liquidity into financial markets.
 - It has negative effects on attracting foreign liquidity into financial markets.
- 3- Specific to the UAE: the regulation of insider dealing should be reformed because:
- It contributed to market deterioration in the summer of 1998 in the UAE unofficial securities market.
 - Insider dealing contributed to the bubble in 2005, which was followed by a sharp correction in 2006 in the local financial markets in the UAE.
 - Transparency and disclosure should be developed in local financial markets in the UAE.
 - The current law prohibiting insider dealing in local financial markets is unclear and it is not practically enforced by the authorities.
 - Criminal prosecutions are inefficient and the SCA should be empowered to administer fines.

Research methods

It should be clear that in law we have a distinct concept of research methodology. There is a distinct legal methodology in solving legal problems. A mere legal discussion of a problem involves interpretation of (among other things) case law and comparison. The difficult task is in attempting to combine social science research methodology with legal methodology to produce a comprehensive thesis. It is true that socio-legal thought has developed considerably in recent years, but legal thought still has a unique research methodology used in argumentation. The important question is: what has this to do with this thesis? The answer is that in this thesis the researcher is attempting to combine legal methodology, which is comparative law methodology, with social science methodology. It would have been less demanding if we had conducted the interviews and questionnaire, and directly introduced the data into the thesis. However, the researcher preferred to introduce a summarized discussion of the research methodology.

There are two main approaches in research methodology; qualitative and quantitative. Qualitative research is appropriate for an in-depth study of the research phenomena. This approach involves investigating the ‘why’ and ‘how’ questions of the research phenomena,

whereas quantitative approach involves investigating the ‘what’, ‘where’, and ‘when’ questions. Qualitative methodology is suitable for focused samples rather than large samples. On the other hand, quantitative methodology is appropriate for investigating the research phenomena by employing a numerical approach to the collection and analysis of data. In other words, quantitative methodology is used to measure mathematically the research phenomena. This is through collecting data from a large sample, using survey methods and employing mathematical models to test research hypotheses.¹⁵⁹

Methodology refers to the rationale which underlies the research, while methods are developed to be applied in the light of the methodology. In practice, interviewing is the commonest method used in qualitative methodology, whereas the questionnaire is commonly used in quantitative methodology. It is also practical to combine quantitative and qualitative methods within the same research. The information provided by quantitative methods can be explained in depth by further qualitative methods.¹⁶⁰

The importance of planning for the research methodology and methods lies in providing the scientific ground for conducting the research. In this sense, the researcher has to rationalize why he chooses one method rather than another for collecting information. The researcher has to make a decision to choose the appropriate research methodology. There are important factors which determines the appropriate strategy; to name but a few, the kind of information to be collected, and where and when to collect it. The research methodology should be determined in the light of the nature of the research problem and the information needed to solve the problem. To make it simpler, the researcher has to decide what approach he will take to conduct the research, yet the chosen approach should be appropriate to the problem investigated.

Our preliminary intention, provided there is a lack of academic resources, was to collect more information to answer the questions in the thesis. We have decided to combine both questionnaire and interviews to collect and analyse the necessary information to answer the study questions.

Having said that combining interviews and questionnaires is appropriate for this study, it should be mentioned that the methods should be tailored to fit the nature of the problem under study. In this study the aim was to measure attitudes of investors towards current

¹⁵⁹ NIGEL GILBERT *Researching Social Life* (London 2nd: Sage Publication, 2001). pp.32-4.

¹⁶⁰ *ibid.*, p.33.

regulation. This was furthered by conducting interviews which provided in-depth expert opinion on the regulation of insider dealing.

Questionnaire

The first method used was the questionnaire, which was directed to investors. It does not seem consistent to ask investors to provide information regarding *why* and *how* insider dealing is regulated. However, it seems proper to measure the opinions and attitudes of investors towards the regulation. For this task, a questionnaire is more appropriate, since it is a study of the trends and opinions of investors. The questionnaire is suitable for measuring the attitudes of investors towards insider dealing, disclosure, transparency and other related points. The questionnaire employed scales where investors were asked to specify their level of agreement.¹⁶¹ The opinions and attitudes of investors are important to support the hypothesis of the study. They also provide an insight into the current situation of marketplace regulation.

The questionnaire as a method has several advantages.¹⁶² It provides information at a low cost in time and money. It also allows the researcher to collect information from many people and the answers can be easily analysed. The questionnaire also provides respondents with the desired anonymity. There are no questions regarding personal information. This aims to make respondents freer when responding to the questionnaire. The questionnaire also avoids interviewer bias. All these factors make it an appropriate method for testing our ideas regarding the regulation of insider dealing.

The researcher explained why the information was being collected through attaching a 'Letter of Consent', a 'Letter from the Supervisor' and an 'Abstract of study' with the questionnaire. In addition, the cover page contained outlines of the research and of the rights of respondents.¹⁶³ These measures were important for proving credibility and increasing the response rate.

The questionnaire was peripherally developed through writing down the broad aims of the thesis. Research questions also provided a basis for the questionnaire. The questionnaire was conducted following the second year of study. This meant that the researcher had a general view of the ideas that needed to be tested. The first step was brainstorming through

¹⁶¹ NIGEL GILBERT *Researching Social Life* (London 2nd. Sage Publication, 2001). p.91.

¹⁶² BILL GILLHAM *Developing a Questionnaire* (London: Continuum, 2000). pp.5-8.

¹⁶³ Details of adopted ethical research principles were explained to the participants through the sent letters and the cover page of the questionnaire. See Appendix 2: translation of the questionnaire (English); and Appendix 4: translation of letter of consent (English).

writing down the research questions and dividing them into specific questions which could be included in a questionnaire. The researcher also made use of the financial media in order to gain an insight into the issues which face investors in UAE financial markets.

The questionnaire was piloted on a reasonable basis, since saving time was critical. The researcher used some important comments from academics.¹⁶⁴ The next step was in the field, where the researcher asked three appropriate investors on the trading floor of Abu Dhabi Financial Market to go through the questionnaire. Watching them and noting their inquiries was an important test for the questionnaire. This exercise provided important observations in terms of the layout of the questionnaire, its clarity and how the respondents perceived the questions. All the observations were taken into account in redefining the questionnaire.

Two main concepts were considered in this questionnaire. First, the length of questionnaire was kept to minimum; since investors' time is valuable they would not have responded to a long questionnaire. Second, there were no personal questions asked in the questionnaire. It did not seem necessary to test variables of age, education and income. Testing the correlation of such variables was not part of our objective. The kind of questions we asked were directed to certain kinds of answers. That is to say 'opinion questions', which required scaled or ranked responses.¹⁶⁵

The final draft of the questionnaire was divided into three sections. In Section 1 the respondents were asked to rank five principles of financial market regulation in order of importance, 1 being the most important and 5 being the least important. The ranking question was directed to exploring the relative importance of the principles. In Section 2 the respondents were asked to select from amongst ten negative aspects of financial markets which they thought were applicable to the markets in the UAE. This question aimed to identify the issues which investors complain about in the markets. Section 3 contained the key questions in the questionnaire. These questions were of 'scale response' design. The scale was of five degrees (strongly agree, agree, neither agree or disagree, disagree, strongly disagree). At the end of each question the respondent was asked to provide comments, if any, supporting his/her choice or presenting further opinions. This section was directed to the main task of the questionnaire which was measuring the attitudes of

¹⁶⁴ The comments were provided by the Supervisor Mr Robert Drury and Professor Anne Barlow from the School of Law.

¹⁶⁵ BILL GILLHAM *Developing a Questionnaire* (London: Continuum, 2000). p.34.

investors to the regulation of insider dealing. Asking for comments aimed at the reasons for their attitudes. The nature and organization of questions were taken into consideration. The questions were ordered from general to particular. There was a fair diversification in question types. Several questions of different types were directed to measure investors' attitudes to the regulation of insider dealing.

There is a body of rules in research methodology which determines how to choose a sample. When it came to sampling, the researcher selected a 'simple random sample'. The research population was investors registered in the local financial markets: the Abu Dhabi Securities Market and the Dubai Financial Market. As of August 2007, the number of registered investors was as follows: in the Abu Dhabi Securities Market the number of registered investors was 8552¹⁶⁶ and in the Dubai Financial Market the number of registered investors was 4008.¹⁶⁷ This meant that the total research population was around 12500 investors.

The size of the sample was to be determined through two factors. First, a larger sample means decreased standard errors. The larger the sample, the more representatively it reflects the research population. Second, the cost of money and time was also considered. This meant that the size of the sample had to be reasonable according to these two factors.¹⁶⁸

The appropriate way was to use conventional statistical calculations. With a research population of 12500, the researcher decided on a 'confidence level' of 95% and a sample of 200. According to the statistics table the 'confidence interval' was therefore 6.87. This meant that if 60% of the sample responded that insider dealing should be regulated, there would be a 95% (which is the confidence level) certainty that the true percentage of the population who would have said the same was between 53.13% (60 – 6.87) and 66.87% (60 + 6.87) where 60 is the percentage in the response and 6.87 is the 'confidence interval'.¹⁶⁹ Therefore, a sample of 200 seemed appropriate for this study.

Following the decisions regarding the type and size of sampling, the researcher commenced with the field work. He contacted the Abu Dhabi Financial Market and the Dubai Financial Market to seek help with sampling and distribution of the questionnaire.¹⁷⁰ The two markets had data related to the registered investors. One difficulty was that information

¹⁶⁶ Reported by the Market Awareness Department, Abu Dhabi Securities Market. 21-Aug-07.

¹⁶⁷ Reported by the Research and Market Relation Department, Dubai Financial Market. 21-Aug-07.

¹⁶⁸ ARLENE FINK *How to Sample in Surveys* (London 2nd. Sage Publication, 2003). p.34.

¹⁶⁹ *ibid.*, pp.43-9.

¹⁷⁰ The researcher would like to thank the Market Awareness Department, Abu Dhabi Securities Market and the Research and Market Relation Department, Dubai Financial Market for their assistance.

regarding investors was confidential and the list of their names could not be disclosed. Therefore, the researcher depended on assistance from the administrative staff of the two markets to distribute the questionnaire. The researcher asked them to distribute the questionnaire to every 60th name on the list of registered investors. Thus, for example, numbers 1, 60, 120, 180 and so on, were chosen.¹⁷¹

The initial response rate was 66%. Thus, the researcher decided to do face-to-face questionnaire with eligible investors on the trading floor of the two markets. This exercise raised the response rate to 78%, a figure which was thought to be adequate for the study purposes.

Interviews

The second method used was interviews. Choosing the interview method can be supported, since it allows the researcher to investigate the case in depth, recognizing its complexity and its context. Interviewing is appropriate for studying an organization, a policy or a process.¹⁷² Interviews allow the researcher to collect information from various and in-depth perspectives regarding one particular case. It is a suitable method for understanding the complexities of the problem. It also allows the researcher to discover the informal realities of an organization or a process.¹⁷³

Interviews are appropriate for investigating the problem of *why and how* insider dealing should be regulated. The case here is the problem of insider dealing as perceived by experienced individuals in the field. Information regarding this problem can be collected through *how and why* questions. The study is of a kind which requires detailed investigation of the problem of insider dealing in practice, and how regulation can be harmonised with real life. Therefore, the study depends on *how and why* investigation to collect information regarding insider dealing from the perspective of those who have the necessary expertise. Such experience is gained by being responsible for introducing and enforcing the rules. Interviews are appropriate to answering in-depth questions in the study.¹⁷⁴

¹⁷¹ This is the result of 12500 (number of registered investors) divided on 200 (sample size).

¹⁷² PUNCH, KEITH F. *Introduction to Social Research: Quantitative and Qualitative Approches* (London: Sage Publication, 2004). p.144.

¹⁷³ DAYMON, CHRISTIAN AND HOLLOWAY, IMMY *Qualitative Research Methods in Public Relations and Marketing Communications* (London: Routledge, 2002). pp.105-6.

¹⁷⁴ For a discussion see YIN, ROBERT K. *Case Study Research: Design and Methods: Third publication. Applied Social Research Methods Series, Volume5* (London: Sage Publication, 2003).

In employing interviews, the aim was to collect more privileged information to answer the thesis questions and to support the findings of the questionnaire. The findings will also be verified by comparison with academic writing on insider dealing, to identify the experience of other jurisdictions in regulating it.

Although interviews are time and money-consuming, this research is small-scale and conducted in an accessible geographical area: my home country, the UAE. This means that time and money were managed economically.

While the questionnaire was more suitable for large numbers, the interviews were directed to a small number of interviewees. The choice of interviewees had to be justified. In this regard, we ensured that logical reasons underlay the selected interviewees for our study. When interviewing officials in the competent authorities and the financial markets there was no real choice. There was not a large number of experts, but rather just a few who needed to be interviewed. The number of interviewees was limited, for example, to those from official authorities who were 'key', and we could not afford to miss any. The interviews also provided an opportunity to contact important people who may have had privileged information.

Perhaps, the best description of our way of selecting interviewees is 'purposive'.¹⁷⁵ In this kind of sampling, the researcher knows the specific informants who are thought to be important for information. Thus, the researcher selected the interviewees with a specific purpose in mind: it was thought that they were important to the investigation. In our study, the interviewees were to make special contributions and they had insight knowledge. Thus, deliberately choosing them was justified. Another justification was that the interviews did not aim to produce generalizations so much as to produce information based on the experience and knowledge of the participants.

When we planned to interview, for example, officials or experts from the Securities and Commodities Authority (SCA) it did not seem necessary to interview a large number from that organization. Interviewing one key member of the SCA was representative and useful. Therefore, we interviewed the legal consultant to the SCA. The same procedure was appropriate for the Abu Dhabi Securities Market and the Dubai Financial Market, where we interviewed the legal consultants. From the Dubai Financial Services Authority, the Regulator of the Dubai International Financial Centre, we interviewed three key

¹⁷⁵ MARTYN DENSCOMBE *The Good Research Guide* (Buckingham: Open University Press, 1998). p.15.

anonymous experts.

It is thought that if the informant trusts the researcher they will disclose more information in face-to-face interviews.¹⁷⁶ Therefore, it was expected that the interviewees would demand that the researcher establish his credibility. First, the researcher contacted the organization and asked for the appropriate person to participate in the interview. Second, the researcher sent a 'Letter of Consent', a 'Letter from the Supervisor' and an 'Abstract of study', either by e-mail or fax.¹⁷⁷ Third, there was no personal connection with the interviewees. The researcher contacted the organizations to which the interviewees belonged to seek access, and they arranged the time and place of the interviews. Fourth, the researcher managed to attend at the right time and place and asked the interviewees to read the letter of consent. Fifth, the researcher always asked the interviewees' permission to sound record the interviews and all the interviews were recorded.

When it comes to the structure of interviewing, there are varied dimensions. Interviews can be classified into three main categories: structured, semi-structured and unstructured. For the purposes of this study, it seemed that the semi-structured interview was the appropriate method to collect information from the chosen participants.

Amongst the various kinds of interviews, we discovered that the 'elite' interview was an appropriate description of the interviews for our study. The 'elite interview' is defined as "...when you interview someone in a position of authority, or especially expert or authoritative, people who are capable of giving answers with insight and a comprehensive grasp of what it is you are researching."¹⁷⁸ It can be confirmed that this is an accurate description of the way in which we conducted the interviews. Our aim was to collect information from those who had the necessary expertise because they were in charge of enforcing insider dealing regulation. Thus, it was proper to say that we aimed to conduct elite interviews. This kind of interviewing has special characteristics which made it appropriate for the purposes of our study. The interviews were unstructured, which meant that the researcher asked a few key open questions and these questions were open-ended. The reason was that the interviewees were experts. They contributed to the researcher's knowledge and they even directed the conversation towards what should be asked. This was

¹⁷⁶ MARTYN DENSCOMBE *The Good Research Guide* (Buckingham: Open University Press, 1998). pp.110-1.

¹⁷⁷ Details of the adopted ethical research principles were explained to the participants through the letters sent. See footnote 163.

¹⁷⁸ BILL GILLHAM *Case Study Research Methods* (London: Continuum, 2000). pp.63-4.

expected of expert interviewees.¹⁷⁹ The interviews aimed to explore experiences rather than general simple data. The questions were 'open' and needed an extended response from the interviewees. The interviewees were given sufficient breadth to speak of their knowledge. They were disconcerted if faced with a series of questions. On the contrary, they had their own structure and reasoning of the problem.¹⁸⁰ In fact, bearing in mind that these were elite interviews, the researcher raised topics rather than questions. The interviews were practical, the aim being to collect information regarding related procedures, documents and other people the researcher may have had to interview.

The elite interviews also had important characteristics which were expected to reflect on the result of the analysis. The researcher conducted ten interviews, seven of them were sound recorded and fully reported in the transcriptions. This was due to the quality of collected information, and its potential for supporting the argumentation. The transcriptions were edited and summarized to highlight the contents reasonably significant to the thesis. Moreover, due to the interview quality and length it was expected that there would be contents which could be directly quoted. This would provide evidence for supporting the argumentation of the thesis.¹⁸¹

¹⁷⁹ BILL GILLHAM *Case Study Research Methods* (London: Continuum, 2000). p.64.

¹⁸⁰ BILL GILLHAM loc.cit.

¹⁸¹ BILL GILLHAM loc.cit.

Results and analysis of the applied study

The questionnaire

Since the questionnaire was directed at Arabic speaking respondents, it was written in Arabic. It was translated into English as precisely as possible, taking into consideration that there would still be linguistic differences. The questionnaire was collected following the second to third week of distribution, to allow respondents adequate time for completion. The analysis of the questionnaire was comparatively easy for a social science questionnaire. There were no multiple variables which required extensive analysis of correlation. The questionnaire aimed at measuring investors' attitudes towards the regulation of insider dealing, without paying attention to variables such as age, income, and gender. Therefore, the researcher decided to use 'Microsoft Excel' as a computer programme. This provided the necessary computation for the collected data. The data were entered to be processed into information that made sense for the purposes of the study.¹⁸²

In Section 1 of the questionnaire the respondents were asked to rank five principles of financial market regulation in order of importance. They were to give 1 as the most important principle, 2 as the next most important principle, and so on. The ranking question was directed to exploring the relative importance of the principles. To make sense of the collected data, we extracted all the responses (1 to 5) and entered them on an Excel spreadsheet. We gave the numerical score (1) where the rank was (1) and the numerical score (2) where the rank was (2) and so on. When we added up all of the numerical scores for each option, the lowest total was the most important priority in financial market regulation, the highest total would be the least important priority in financial market regulation, and so on.¹⁸³ The results of this section are represented in Table 1.

¹⁸² See Appendix 5: questionnaire numerical scores.

¹⁸³ This method has been criticized by mathematicians arguing that it implies an interpretation of scale to say it can only represent how much respondents prefer one option to another. However, it has hardly been argued that this method is invalid to represent the overall order of preference. A detailed discussion of these arguments is beyond the remit of this thesis.

Table 1: Ranking of five principles of market regulation. Total numerical scores where the lowest total represents the most important priority in financial market regulation, the highest total represents the least important priority in financial market regulation, and so on.

	Total numerical score.	Rank
1- Financial markets should be transparent and issuers should make timely disclosure of any inside information.	336	1
2- Financial markets should be controlled only by economic factors, not by regulations.	543	5
3- Insiders should not be allowed to use inside information for their own benefit.	519	4
4- Investors in financial markets should be put on an equal footing and their rights should be protected.	387	2
5- There should be an implementation of international standards of regulation in the local financial markets of any country.	420	3

An analysis of the collected data revealed the following results:

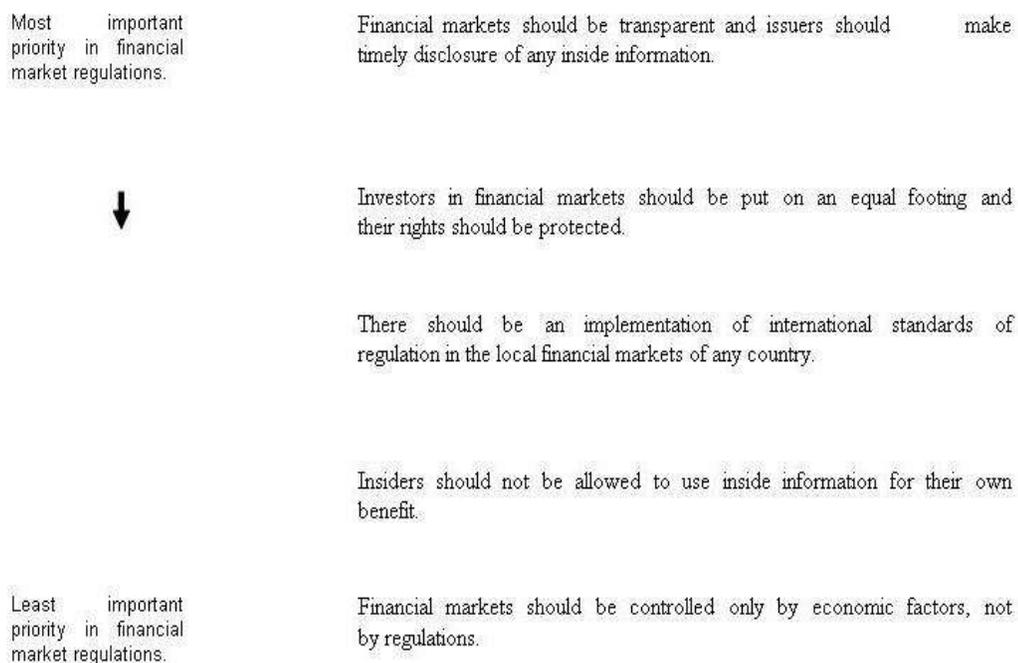


Figure 1: Ranking of five principles of market regulation.

The results show that investors think that the first priority is that ‘financial markets should be transparent and issuers should make timely disclosure of any inside information’. The

second priority was that ‘investors in financial markets should be put on an equal footing and their rights should be protected’. The third priority was that ‘there should be an implementation of international standards of regulation in the local financial markets of any country’.

It is surprising that investors thought that the second least important principle was ‘insiders should not be allowed to use inside information for their own benefit’. In fact the numerical scores show a slight difference between the fourth and the fifth ranked principles. In other words, respondents gave the regulation of insider dealing a very low importance. However, this does not necessarily mean that the regulation of insider dealing is not important. This view is supported by the fact that the results of the following questions show a different attitude towards the regulation of insider dealing, where investors paid more attention to the practice. Perhaps the most important principle for investors is that the market is transparent and issuers make a timely disclosure of any inside information. In any case, this is what they require from the market. If it was explained to them that insider dealing may affect transparency and delay timely disclosure, they may have selected the regulation of insider dealing as a high priority.

Investors also made ‘financial markets should be controlled only by economic factors, not by regulations’ the least important principle in financial markets regulation. In fact this principle was introduced to test the hypothesis by some economists that economic factors should be considered in regulating financial markets. It tests investors’ preference between controlling the market by economic factors or by regulation. The results show that investors prefer regulatory intervention to control financial markets.

Investors prioritised the three most important principles of financial market regulations as follows:

1. Financial markets should be transparent and issuers should make timely disclosure of any inside information.
2. Investors in financial markets should be put on an equal footing and their rights should be protected.
3. There should be an implementation of international standards of regulation in the local financial markets of any country.

In fact, these three principles are the main basis of arguments that insider dealing should be regulated in diverse jurisdictions. The first two principles are used by the researcher to sustain his argument that there should be further regulation of insider dealing in the UAE.

In Section 2 of the questionnaire the respondents were asked to select from ten negative aspects of financial markets which they thought were applicable to the local markets in the UAE. This question aimed to identify the issues which investors complain about in the markets, and to measure relatively the current problems which investors face. (See Figures 2, 3 below).

Figure 2: Negative aspects of local financial markets in the UAE vs. percentage of investors who think that such aspects are applicable to the local markets in the UAE.

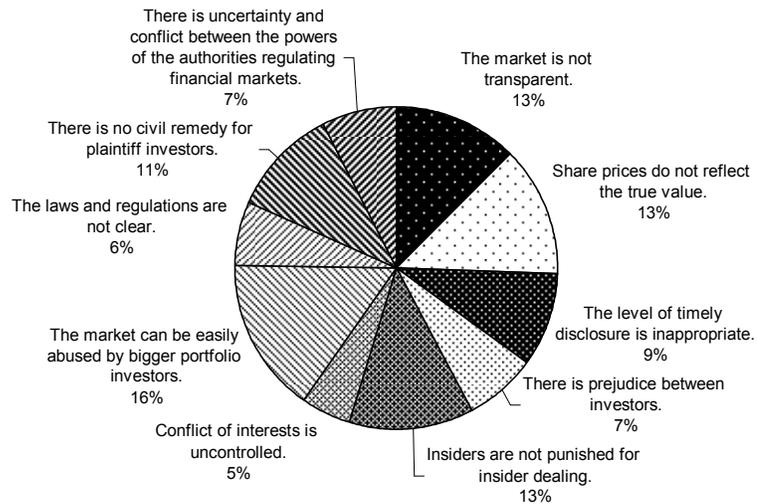


Figure 2: Negative aspects of local financial markets in the UAE vs. percentage of investors who think that such aspects are applicable to the local markets in the UAE.

Figure 3: The percentage of negative aspects in the local financial markets vs. percentage of investors who thought that such aspects are applicable to the local markets in the UAE.

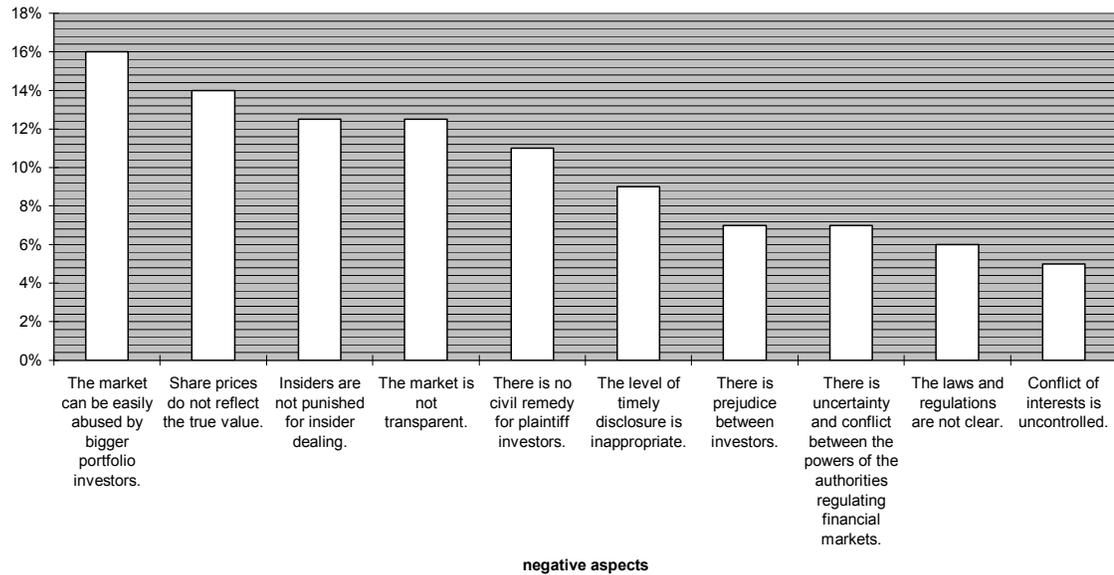


Figure 3:

The results show that investors think that the most significant problems in UAE local financial markets are:

- 1- The market can be easily abused by bigger portfolio investors.
- 2- Share prices do not reflect the true value.
- 3- Insiders are not punished for insider dealing.
- 4- The market is not transparent.

This means that insider dealing was thought by investors to be a significant problem. In fact, it was the third most significant problem in the markets. This shows a different result from that in Section 1, where the regulation of insider dealing seemed to be unimportant. It is also important to note that the most negative aspect was thought to be ‘the market can be easily abused by bigger portfolio investors’. This means that investors think that there is ‘market abuse’ and they feel that it is a negative aspect which has not been resolved. It is the researcher’s view that market abuse and insider dealing both come under the umbrella of market misconduct. All such acts need tougher financial markets regulation.

It is also important that investors think that the second negative aspect was ‘share prices do not reflect the true value’. Such a view indicates the emergent level of the market in terms of share price informativeness. This may be because investors think that ‘the market is not transparent’. It may also provide an indication that investors think that there is insider

dealing and market abuse which affect market transparency and cause uninformative share prices. Investors also think that the fifth negative aspect was ‘there is no civil remedy for plaintiff investors’.

However, one result in these findings may undermine this conclusion, although it does not completely render it false. Only 9% of investors thought that ‘the level of timely disclosure is inappropriate’. This result slightly undermined the general trend of investors’ attitudes, considering that 13% of investors believed that ‘the market is not transparent’ and 14% believed that ‘share prices do not reflect the true value’. In other words, ‘the level of timely disclosure is inappropriate’ was the sixth negative aspect, and this weakened the conclusion that the market was not transparent.

This trend is similar to what experts in local financial markets think of the level of disclosure. This was obvious in the interviews. When interviewees were questioned on the subject of the level of disclosure, they said that there was sufficient regulation of disclosure. However, discussing problems of disclosure in more detail revealed that there were shortcomings in the regulations. For example, a common difficulty was:

This is also a problem in our jurisdiction, which is the disclosure of information to the media before an official disclosure to the regulator. This is dangerous. The news may be published inaccurately and differently from one section of the media to another. It may also be written in a certain way, or a part of the information which does not reflect the whole may be given.¹⁸⁴

Both investors and experts thought that the level of disclosure was acceptable to a certain degree. However, when they were asked in more detail, their opinions revealed gross shortcomings in disclosure, such as leaking information to the media and selective disclosure.

The last four negative aspects which were thought by investors to be the least applicable to UAE markets were: ‘there is prejudice between investors’, ‘there is uncertainty and conflict between the powers of the authorities regulating financial markets’, ‘the laws and regulations are not clear’ and ‘conflict of interests is uncontrolled’.

It is surprising that investors do not feel more strongly that ‘the laws and regulations are not clear’. In fact, they are not clear even to legal counsels. The interviews show a different result, where expert interviewees think that the laws and regulations are not clear. They also

¹⁸⁴ TOJAN AL SHURIDEH, Legal Consultant, Securities and Commodities Authority *Interview Transcript*. See Appendix 6, Interview (3).

think that there is uncertainty and conflict between the powers of the different regulators, and there is uncontrolled conflict of interests.

When asked about the clarity of the laws and regulations, Habib Almula, Former MP (Member of the Federal National Council) and Former Chairman of the Dubai Financial Services Authority said:

The laws and regulations of the SCA have been issued without prior rigorous study. The drafting team constituted non-specialists in financial markets and securities regulation. The laws were issued with no comparison with the laws and regulations in financial markets in developed countries. This fact resulted in our not benefiting from the experiences of other jurisdictions and we wasted a chance to avoid the shortcomings of such jurisdictions. There are legal and judicial precedents which could have been beneficial if considered in drafting the new law. Introducing details of the new law should also have been considered, because there are no judicial precedents which can be used as directions by the courts. As a consequence, all these factors caused the issuing of superficial laws.¹⁸⁵

He also said:

It can be said that there are no legal rules accurately drafted to face the problem of insider dealing. There has to be administrative penalties. There have to be civil remedies. Proper authority should be given to the SCA.¹⁸⁶

The legal advisor of the Abu Dhabi Securities Market agreed that there was uncertainty and overlap between the regulatory authorities:

I agree. In UAE law there is a great overlap between the responsibilities of the SCA and the markets. This issue needs to be radically resolved by a federal law, which should segregate between the role of the SCA and that of the markets... Yes, there is overlap, and this is known by the SCA and the markets.¹⁸⁷

One explanation of the difference between the attitude of investors and experts is the perspective they take on the problem. Investors look for real results on the floor. Their opinion can be indicative of the level of transparency, informative share prices and market abuse. They may have little experience of what good quality regulation is and how it can be enforced to solve the problems they face. Therefore, on plain legal issues, it could be argued that a few expert opinions may provide a better indication than a large number of investors' opinions.

¹⁸⁵ HABIB ALMULLA, Former MP (Member of the Federal National Council) and Former Chairman of the Dubai Financial Services Authority, *Interview Transcript*. See Appendix 6, Interview (4).

¹⁸⁶ *ibid.*

¹⁸⁷ MITHKAL OBAIDAT, Legal Advisor, Abu Dhabi Securities Market, *Interview Transcript*. See Appendix 6, Interview (2).

In Section 3 of the questionnaire, the questions were designed for a 'scale response'. This section was directed to the main task of the questionnaire: measuring attitudes of investors towards the regulation of insider dealing. In analysis, the researcher combined 'strongly agree' and 'agree' because both indicate 'agree'. The same was done with disagreement. This aimed at calculating the average of agreement and disagreement and avoiding extravagant trends of investors' opinions. At the end of each question the respondent was asked to provide comments, if any, supporting his/her choice or presenting further opinions. Asking for comments aimed at identifying why they have such an attitude, there were a number of valuable comments which could provide explanations for numerical quantitative results. The results are illustrated by figures which, by design, highlight the percentages of responses.

The questions in Section 3 of the questionnaire were purposely ordered. They began by asking investors their opinions regarding insider dealing in general. Then they were questioned regarding possible occurrences of insider dealing in the UAE. Following this, they were asked regarding possible solutions to insider dealing.

There has always been controversy regarding the ethical element in regulating insider dealing. Investors were asked and, interestingly, the results showed that 92% of investors thought that insider dealing was unfair to other investors who did not have access to inside information. Only 4% of investors disagreed (Figure 4). Some comments given by investors provided important indications. Some of the investors commented: “It (insider dealing) creates an atmosphere where there is inequality of opportunities”; “There should be equality between insiders and shareholders investors”; and “All information should be made clear for all investors”. These results are also supported by the findings of the interviews:

Interviewer: There are economists who argue that insider dealing should not be prohibited.

Interviewee: Justice requires that regulators are established to provide information for all investors at the same time and of the same quality. There should not be dissimilarity in informing. Is it fair to allow insiders to exploit inside information? Why should other investors lose because of them?¹⁸⁸

Figure 4: Do you think that insider dealing is unfair to other investors who do not have access to inside information?

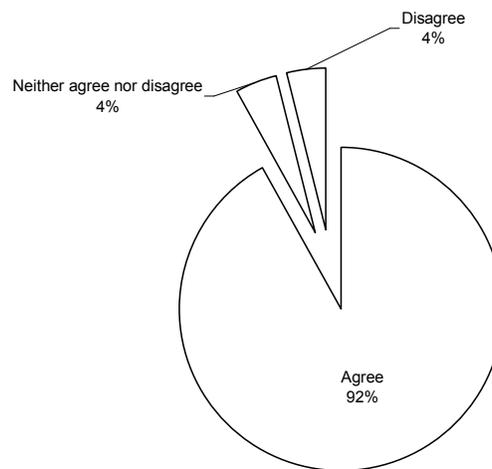


Figure 4

¹⁸⁸ TOJAN AL SHURIDEH, Legal Consultant, Securities and Commodities Authority *Interview Transcript*. See Appendix 6, Interview (3).

When asked whether insider dealing has negative effects on the transparency of the market, 86% of investors agreed. Only 2% of investors disagreed, while 12% neither agreed nor disagreed (Figure 5). They commented that: “This (insider dealing) causes non-transparency” and “Because he (the insider) knows the price of the securities depending on non-public information”.

Figure 5: Do you think that insider dealing has negative effects on transparency in financial markets?

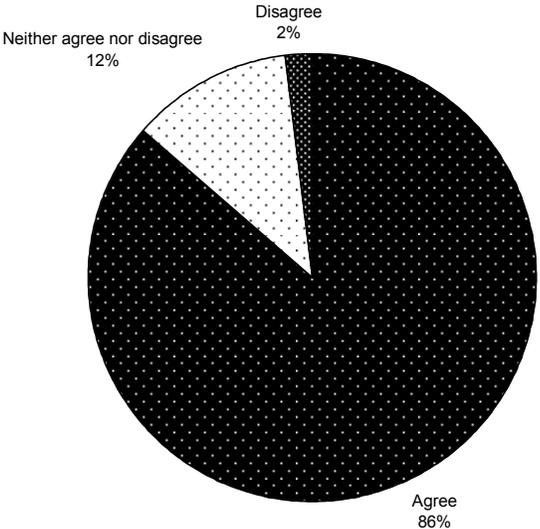


Figure 5

An important hypothesis which needed to be tested was the effects of insider dealing on investor confidence. A total of 86% of investors think that insider dealing has negative effects on investor confidence in the market, whereas only 8% disagree (Figure 6). One of the investors who thought that insider dealing may not have significant effects on the economic efficiency of the market said: “We complain when we lose and do not complain when we make a profit. But confidence is more important than making a small profit”. We asked the legal consultant of the SCA regarding the role of regulations:

Interviewer: What will the rules do?

Interviewee: They at least sustain confidence in the markets. It will not give the chance for everyone to exploit the situation.¹⁸⁹

An anonymous interviewee from the Dubai Financial Services Authority (DFSA) also said:

The financial systems are built primarily on their integrity. Once they lose their integrity you may find that there is a collapse in the financial system. If you look at the not-so-recent big collapses in the US during the last ten years, the effect of that was a disruption to the confidence in the system.¹⁹⁰

Figure 6: Do you think that insider dealing has negative effects on investor confidence in financial markets?

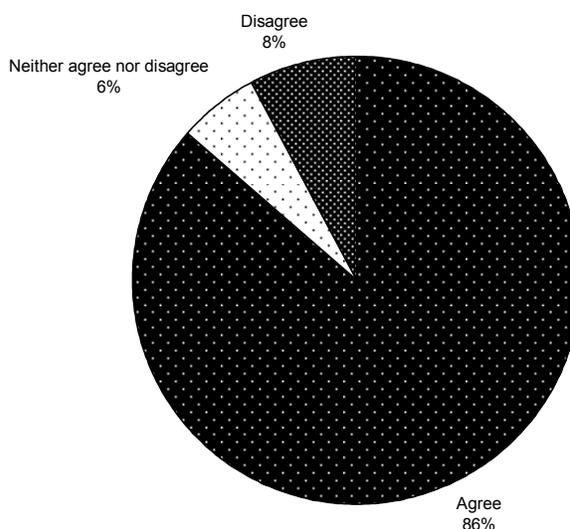


Figure 6

¹⁸⁹ TOJAN AL SHURIDEH, Legal Consultant, Securities and Commodities Authority *Interview Transcript*. See Appendix 6, Interview (3).

¹⁹⁰ ANONYMOUS 2, Dubai Financial Services Authority, *Interview Transcript*. See Appendix 6, Interviews (5), (6) and (7).

When it came to the negative effects of insider dealing on the economic efficiency of the market, the percentage of agreement declined. Of investors, 63% agreed that insider dealing negatively affects market efficiency. One of them commented “It (insider dealing) affects the powers of supply and demand in the market”. But it is important to note that 27% of investors neither agreed nor disagreed (Figure 7). The last result showed that investors were unable to provide a certain answer. This is, though, not surprising. As we discussed earlier, even financial economists reached controversial results in this regard.

Figure 7: Do you think that insider dealing has negative effects on the economic efficiency of financial markets?

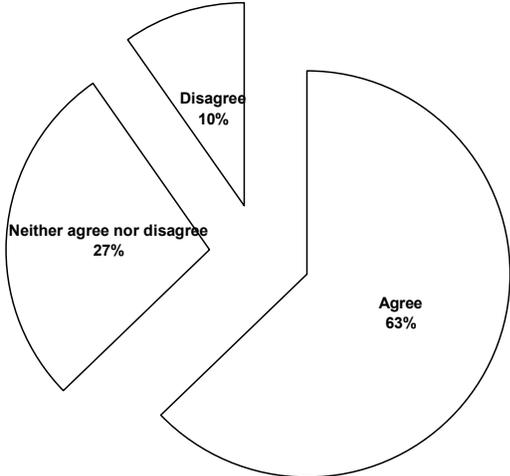


Figure 7

When asked whether insider dealing had effects on the economy of the country, 57% of investors agreed, whereas only 16% disagreed. Also, a large percentage (27% of investors) neither agreed nor disagreed (Figure 8). This is justified, as one investor responded: “Because the economy of the country is not confined to portfolio management”. It means that it is difficult to see the effects of market abuse on the larger economy, except when such abuse is significantly serious.

Figure 8: Do you think that insider dealing has negative effects on the economy of the country?

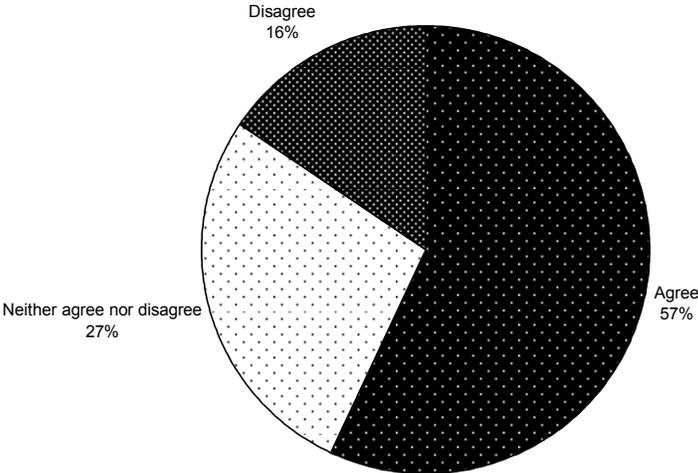


Figure 8

Investors were asked whether they thought that insider dealing has negative effects on attracting liquidity into the markets. A total of 72% of investors agreed that insider dealing caused liquidity escape, while only 12% disagreed (Figure 9). One of them said: “Because of losing confidence capital hesitates entering into the market”.

Figure 9: Do you think that insider dealing has negative effects on attracting liquidity into the financial markets?

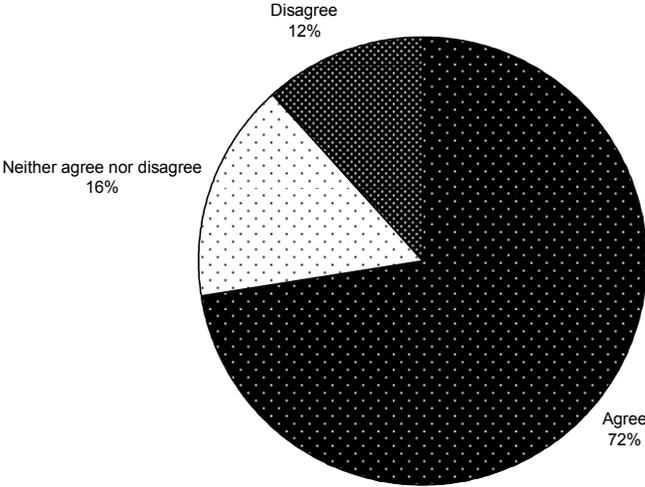


Figure 9

Then investors were asked whether insider dealing repelled foreign liquidity from the market. Of investors, 71% agreed, while only 4% disagreed. But a large percentage (25% of investors) neither agreed nor disagreed (Figure 10). Interviews also showed supporting results. An anonymous member of the Dubai Financial Services Authority said:

...when you say that you want to open up the Dubai market, the rest of the world will be looking at you. If there is insider dealing activity they say, 'why are you not doing anything about it? You are advantaging other investors over me, so I am not going to invest my money there.'¹⁹¹

Figure 10: Do you think that insider dealing has negative effects on attracting foreign investments into the financial markets?

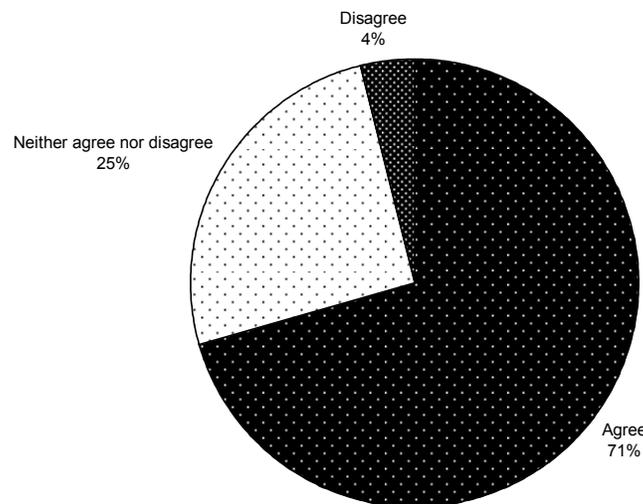


Figure 10

¹⁹¹ ANONYMOUS 1, Dubai Financial Services Authority, *Interview Transcript*. See Appendix 6, Interviews (5), (6) and (7).

The aforementioned questions were directed to enquire about the negative effects of insider dealing. They were followed by asking investors an important question: “do you think that insider dealing should be prohibited?” The vast majority of investors (78%) thought that insider dealing should be prohibited. Only 12% of investors disagreed and 10% neither agreed nor disagreed (Figure 11). This shows the attitude of investors towards insider dealing and supports the argument that insider dealing should be regulated.

Figure 11: Do you think that insider dealing should be prohibited?

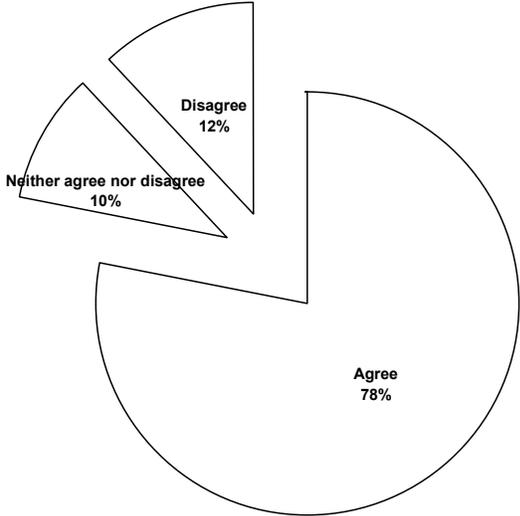


Figure 11

The following questions were used to enquire about possible solutions to insider dealing. When they were asked whether insider dealing could be dealt with by financial market regulation, the majority of investors (74%) agreed, while only 14% disagreed (Figure 12). This provides a clear result, since it is supported by other results in the questionnaire. In fact, it supports the general attitude of investors who, according to the questionnaire, think that insider dealing is a problem they face and regulation should be developed to international standards.

Figure 12: Do you think that insider dealing can be dealt with by financial market regulation?

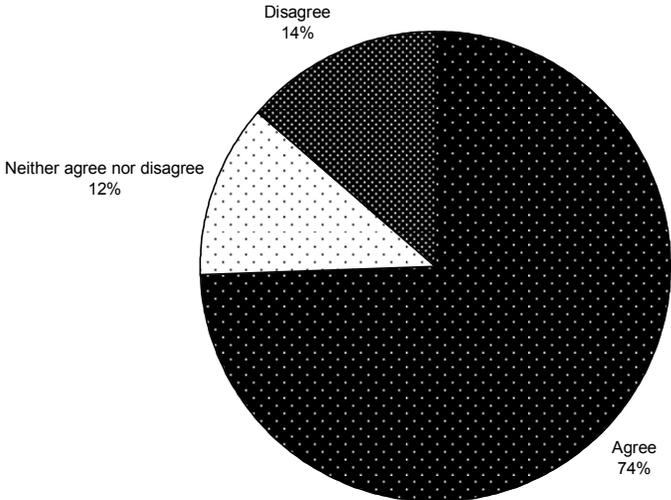


Figure 12

Another important hypothesis tested by the questionnaire was the necessity of adopting international standards. Investors were asked: “do you think that adopting international regulatory standards is necessary to advance the transparency of the local financial markets in the UAE?” The results were noteworthy. Almost all investors (98%) agreed that international regulatory standards should be adopted in local financial markets in the UAE, whereas only 2% disagreed. This result shows the importance of adopting international standards in financial market regulation. It also provides a solid basis for the argument that in the UAE investors want to raise the level of transparency to international levels. In fact, this was one of the main reasons for establishing the Dubai International Financial Centre. As one interviewee said:

The reason why a separate financial market was created was that there is no financial market between Singapore and London that is aligned with international standards. What we do have is some local regional markets; none of these markets operates in accordance with international standards.¹⁹²

Figure 13: Do you think that adopting international regulatory standards is necessary to advance the transparency of the local financial markets in the UAE?

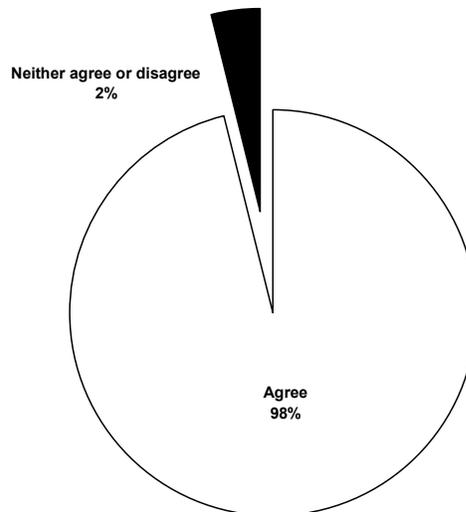


Figure 13

¹⁹² ANONYMOUS 1, Dubai Financial Services Authority, *Interview Transcript*. See Appendix 6, Interviews (5), (6) and (7).

We asked investors whether insider dealing and market abuse contributed to the unofficial securities market in the UAE in 1998. Only 10% of investors disagreed, 18% neither agreed nor disagreed and the majority (72%) agreed (Figure 14). It is noteworthy that international reports confirmed that there was market abuse and insider dealing which contributed to the collapse. Perhaps one reason why some investors disagreed was the confusion as to whether there was a market at all. One of them commented: “In 1998 there was no financial market at all”. It is always difficult to explain to respondents all the details. The question was specified by the term “unofficial securities market”. There was a market in 1998 from an economic perspective, but it was unofficial and unregulated. One of the investors who strongly agreed said: “And absence of laws regulating it (insider dealing)”.

Figure 14: Do you think that insider dealing and other market abuse contributed to market deterioration in the summer of 1998 in the UAE unofficial securities market?

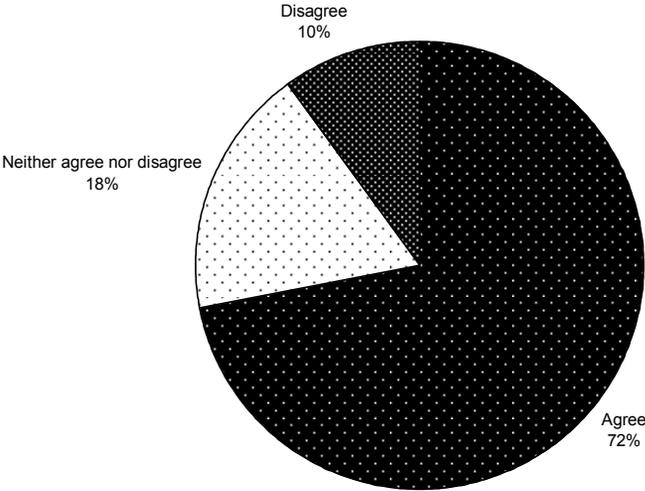


Figure 14

We asked investors regarding another important turning point in local financial markets in the UAE. The question was: “do you think that insider dealing and other market abuse contributed to the bubble of 2005, followed by the sharp correction of 2006 in the local financial markets in the UAE?” Only 10% of investors disagreed, 12% neither agreed nor disagreed and a significant majority of 78% agreed (Figure 15). This finding supports those investors who think that there is no transparency and there is insider dealing activity. These respondents agreed when asked whether such factors contributed to the bubble.

By the word “contributed” in the question, we indicated that insider dealing and market abuse were not the only causes, but had only contributed to the bubble. There are, of course, other reasons for the bubble. These points could not be explained in more detail, because the question had to be as simple as possible.

One investor who strongly agreed said: “There is no protection in the market; small investors are mostly the plaintiffs”. Another who agreed stated: “The other reason is withdrawing liquidity from the market”. The latter comment also proves that investors were thinking about other causes.

Figure 15: Do you think that insider dealing and other market abuse contributed to the bubble of 2005 followed by the sharp correction in 2006 in the local financial markets in the UAE?

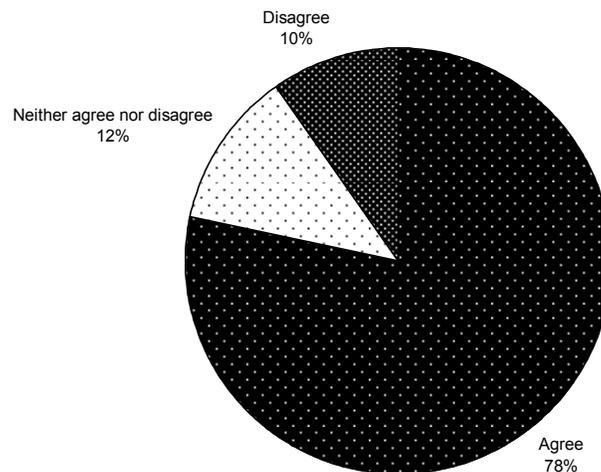


Figure 15

Subsequent to the above-mentioned questions, we asked investors: “do you think that the current regulations are sufficient for avoiding further deterioration in the local financial markets in the UAE?” Of those asked, 40% of investors disagreed that the current regulations were sufficient, whereas 33% agreed. It is important to note that a large percentage (27%) neither agreed nor disagreed (Figure 16). This may indicate that they were uncertain, either regarding the quality of current regulation or the predictability of further deterioration. One investor who agreed commented: “They are efficient to some extent”. Another who disagreed said: “There should be more regulation benchmarked to Malaysian regulation”.

Figure 16: Do you think that the current regulation is sufficient to avoid further deterioration in the local financial markets in the UAE?

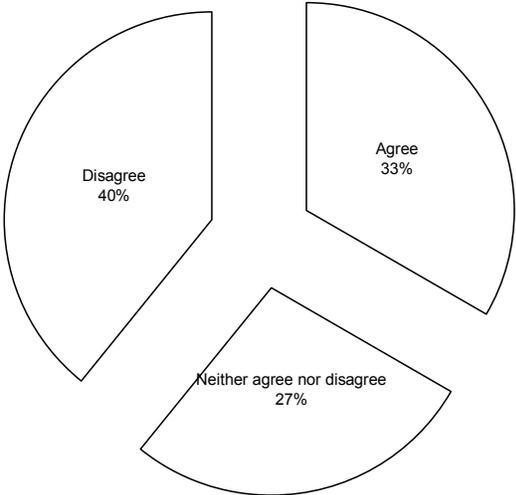


Figure 16

It was important to measure investors' attitudes towards the level of protection of their rights in the markets. We asked them: "do you think that investors' rights are protected in the local financial markets in the UAE?" The majority (52%) of investors thought that their rights were not protected, 24% agreed that there was protection for their rights, while 24% neither agreed nor disagreed (Figure 17). The responses may have been affected by investors' different experiences in terms of the protection of their rights. One of them asserted: "There is no protection of investors' rights in the country". Another maintained: "There is no protection at all, especially for small investors".

Figure 17: Do you think that investors' rights are protected in the local financial markets in the UAE?

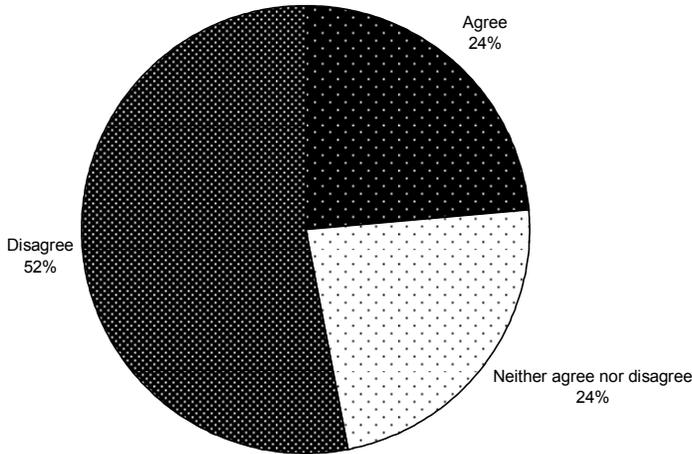


Figure 17

A significant finding was made when investors were asked: “do you think that transparency and disclosure should be developed in the local financial markets in the UAE?” Almost all investors (98%) agreed, while only 2% neither agreed nor disagreed (Figure 18). None of the investors disagreed. This noteworthy result also showed the importance of transparency and disclosure from the investors’ point of view. The questionnaire measured this importance, and in this question it measured the need for more development in transparency and disclosure. One of the investors who strongly agreed commented: “The media should get involved in the market. The level of issuers’ disclosure obligations should be raised. Investors should see the dealings”.

Figure 18: Do you think that transparency and disclosure should be developed in the local financial markets in the UAE?

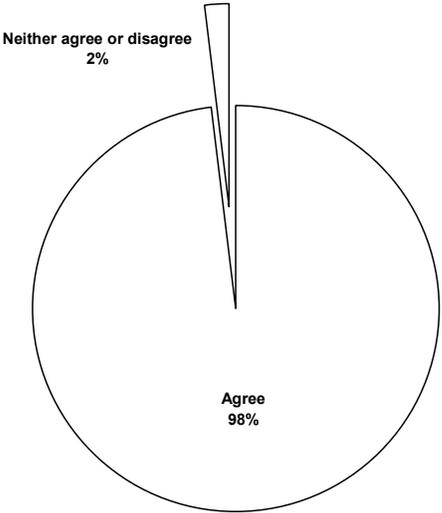


Figure 18

In Section 2 of the questionnaire it appears that investors do not see the clarity of the laws and regulations as a problem in local financial markets in the UAE. A similar question was asked again: “do you think that the current law prohibiting insider dealing in the local financial markets in the UAE is clear?” Of investors, 40% thought that the law was not clear, 31% agreed that it was clear and 29% neither agreed nor disagreed (Figure 19). It can be said that a majority thought that the law of insider dealing was not clear. One investor went further when he commented “There is no law preventing insider dealing”. However, to depend on normal investors’ opinions on a complicated legal point in which they have little experience is unsound. The results show that 29% of investors neither agreed nor disagreed. This probably indicates investors’ lack of knowledge regarding the law.

Figure 19: Do you think that the current law prohibiting insider dealing in the local financial markets in the UAE is clear?

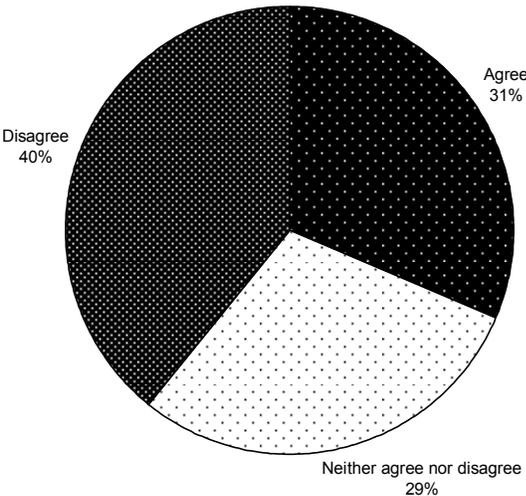


Figure 19

Subsequent to the last question, investors were asked: “do you think that the current law prohibiting insider dealing in the local financial markets in the UAE is practically enforced by the authorities?” A total of 35% of investors disagreed, 36% neither agreed nor disagreed and only 29% agreed (Figure 20). The responses are quite similar to those of the last question. Thus, from the results of these two questions it is unsafe to reach a conclusion. In these two questions, when asking investors regarding the law and regulation, we obtain break down results as indicated in Figures 19 and 20. One explanation why the results do not show an assertive opinion by investors is that in practice they do not see the whole picture. Investors know their part of the process, but they do not necessarily understand the law and regulation of the markets. It can only be said from the earlier question that to a certain degree the law of insider dealing is unclear.

Figure 20: Do you think that the current law prohibiting insider dealing in the local financial markets in the UAE is practically enforced by the authorities?

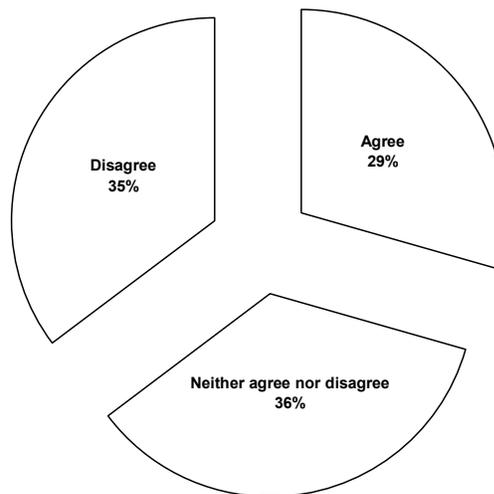


Figure 20

One of the basic tenets of the thesis is that disclosure is a practical preventive weapon against insider dealing. Investors were asked: “do you think that insider dealing can be prevented by raising the level of transparency and disclosure in the regulations?” The response shows that a substantial majority of investors (82%) agreed, while only 4% disagreed (Figure 21). This result builds on former questions which all prove that disclosure is by far the most vital issue for investors, and perhaps for all market participants.

Figure 21: Do you think that insider dealing can be prevented by raising the level of transparency and disclosure in the regulations?

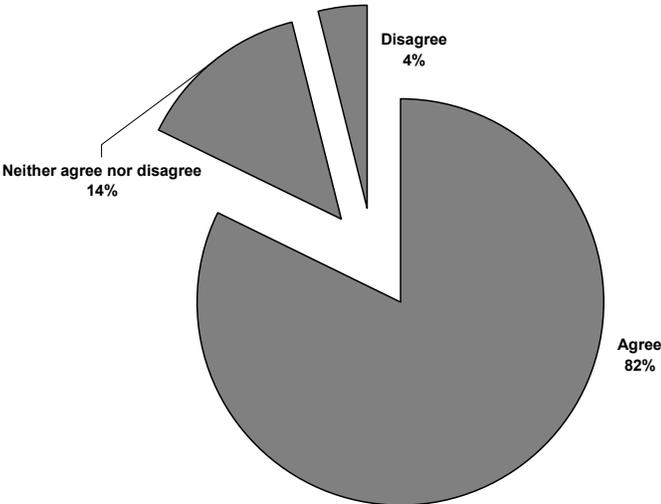


Figure 21

The last two questions aimed to measure investors' opinion regarding the punishment of insider dealing. They were asked: "do you think that a criminal trial and punishment is effective in deterring insider dealing?" Among investors, 70% agreed amongst them 20% strongly agreed. Only 12% of investors disagreed (Figure 22). This may indicate the frustrated attitude of investors towards insiders. In general, it is thought that some jurisdictions criminalized insider dealing to meet the public's demand. Yet, it does not mean that a criminal punishment is a deterrent, since it is hardly ever applied. Investors' attitudes can be summed up by one of their number. He stated on the use of the criminal law: "To protect peoples' rights from abuse".

Figure 22: Do you think that a criminal trial and punishment is effective in deterring insider dealing?

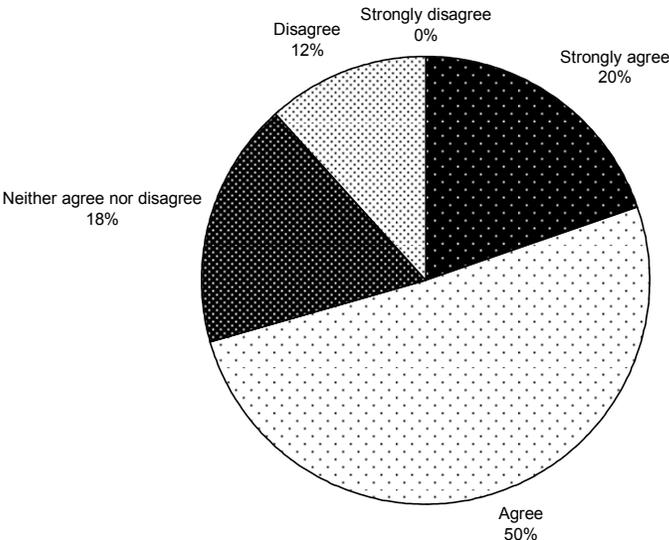


Figure 22

In the last question we asked investors: “do you think that fines administered by the SCA would be more of a deterrent to insider dealing than a criminal punishment?” The results were as follows: the majority of investors (60%) agreed, amongst them 31% strongly agreed. Some 16% of them disagreed and 12% strongly disagreed. Those who agreed thought that “The fine should be a deterrent”, but they also thought that “The SCA currently is unqualified to do it”. Investors who disagreed commented: “Without a trial it would not be a deterrent” and “Because the SCA is unable to make a criminal prosecution, since it is not qualified to do it”.

This result is also supported by the interviews. When we asked one interviewee: “is the SCA efficient at the present?” he said: “No, I honestly tell you, and record it”.

Figure 23: Do you think that fines administered by the SCA would be more of a deterrent to insider dealing than a criminal punishment?

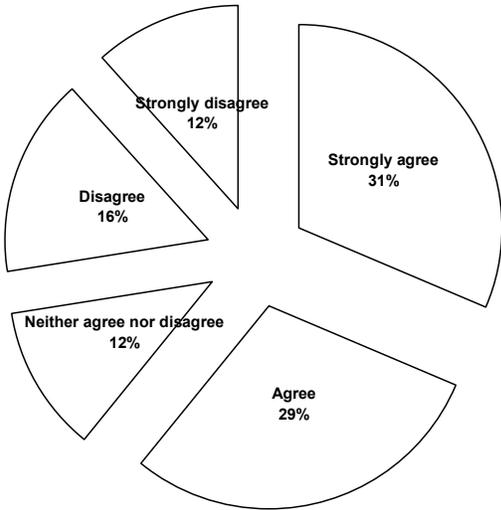


Figure 23

Interviews

Hitherto, the analysis has given some indications of the interviews. In fact, the interviews were so long that summarising them in less than one subsection may undervalue their results. They resulted in more than 5 hours of recordings, the transcripts of which are extensive. For example, the transcript of the interview with a team from the DFSA was approximately 4500 words; all of it contained important discussions and opinions. Therefore, the researcher decided that it would be better if the interviews were spread throughout the thesis.¹⁹³

The researcher conducted ten interviews, seven of them were sound recorded and fully reported in the transcripts. The other three interviews were for the researcher, as they provided an insight into the mechanisms for administering compliance and watching the markets. The interviewees were from the administrative staff of both local markets. They constituted a beginning for the researcher. The transcripts of the other seven interviews contained important discussions and opinions that could be used to support the arguments of the thesis. Moreover, due to the quality and length of the interviews it was expected that there would be contents which could be directly quoted. This would be useful in providing evidence to support the argument of the thesis.

The first interviewee was Mithkal Obaidat, Legal Advisor to the Abu Dhabi Securities Market. The questions in the interview related to the role of the market in enforcing the law, his opinion regarding the rules directed to insider dealing and any recommendations for reform.

The second interview was with Abdulla Al Dhaheri a Head of Section in Listing and Compliance in the Abu Dhabi Securities Market. The questions in the interview related to the role of his section in enforcing the rules on insider dealing, enforcing the regulations of disclosure and areas in which they face difficulty that may need further regulation.

The third interviewee was Tojan Al Shurideh, Legal Consultant to Securities and Commodities Authority. The questions in this interview related to the rules dedicated to regulating insider dealing. The interview concentrated on how the rules could be interpreted and applied, shortcomings in their drafting, and recent amendments, recommendations and proposals.

¹⁹³ All transcripts are included in Appendix 6.

The fourth, fifth and sixth interviewees preferred to be simultaneously interviewed and they asked for anonymity. Therefore, they were numbered 1, 2 and 3. It can only be said that they were DFSA staff. The questions in the interview related to discussing the separate jurisdiction of the DIFC, the reasons for establishing it, and how local markets could benefit from its regulations and international standards of regulation.

The seventh interviewee was Habib Almulla, former MP (Member of the Federal National Council) and former Chairman of the Dubai Financial Services Authority. The interview could not be recorded due to technical problems. Nevertheless, the interviewee provided an important outline of opinions regarding a comparison between the DIFC and local financial markets, the shortcomings in local financial markets regulations and the principles of any amendments.

A summary of the results of the applied study

It is important to represent briefly the main results of the applied study, avoiding any repetition. It can be said that:

- 1- Investors think that the most important priorities of financial markets are; ‘financial markets should be transparent and issuers should make timely disclosure of any inside information’ and ‘investors in financial markets should be put on an equal footing and their rights should be protected’. Almost all investors think that transparency and disclosure should be developed in local financial markets in the UAE. They also think that insider dealing can be prevented by raising the level of transparency and disclosure in the regulations. Another critical result of the questionnaire is that most investors think that their rights are not protected in the local financial markets in the UAE.
- 2- The issues which investors complain most about in the UAE local financial markets are:
 - ◆ Insider dealing was thought to be a significant problem by the investors.
 - ◆ The market can be easily abused by bigger portfolio investors.
 - ◆ Share prices do not reflect the true value.
 - ◆ Insiders are not punished for insider dealing.
 - ◆ The market is not transparent.
- 3- The applied study showed that most investors and experts think that:
 - ◆ Insider dealing is unfair.
 - ◆ Insider dealing has negative effects on the transparency of the market, investor confidence, the economic efficiency of the market, the economy of

the country, and attracting liquidity and foreign investments into the markets.

- 4- The majority of investors think that insider dealing should be regulated. They think that it could be dealt with by implementing international regulatory standards. This is supported by the experts who showed consensus that insider dealing should be regulated.
- 5- The majority of investors think that insider dealing contributed to the deterioration in the UAE markets in 1998 and 2006. They also think that the current regulations are insufficient for avoiding further deteriorations in the local financial markets.
- 6- Most of the investors think that the current law prohibiting insider dealing in the financial markets in the UAE is not clear. They also think that the current law is not practically enforced by the authorities. The interviews support the view that the laws and regulations are not clear and that there is uncertainty and conflict between the powers of the authorities regulating financial markets. Expert interviewees explained in-depth their opinions in regard to the current regulation of insider dealing. They supported our proposition that there are gross shortfalls in the regulation, as was explained in the preceding chapter. They also agreed that there should be reform to the regulatory system, and that the SCA as a regulator should be more empowered and efficient.
- 7- Most of the investors thought that a criminal trial and punishment would be effective in deterring insider dealing. However, they also agreed that fines administered by the Securities and Commodities Authority would be more of a deterrent to insider dealing than a criminal punishment.

Conclusion

This applied study provides solid ground for testing hypotheses and supporting the arguments of the thesis. The fact that the applied methodology is half the story, while the other half is a comparative legal study, should be taken into consideration. Thus, the applied study has been conducted on a reasonable scale. There should not be over-dependence on the findings of this study, since they only provide certain indications for the research. Only further in-depth applied study in the same area, which is lacking at the moment, can verify the results of this study.

A summary of the results of the study shows that comparing the opinions of experts with those of investors who receive the service provided essential results for the inquiry regarding the regulation of insider dealing.

The analysis of the questionnaire is more straightforward because it is numerical and can easily be computed. In contrast, the interviews were unstructured and resulted in extensive transcripts similar to academic articles. The interviews can be depended on as references producing qualitative opinions whenever needed in the thesis.

Chapter 4: comparative regulation of insider dealing

Introduction

- The regulation of financial markets in the US

- The regulation of insider dealing in the US

 - Section 16(b) of the Securities and Exchange Act 1934 and Section 17(a) of the Securities Act 1933

 - Section 10(b) of the Securities and Exchange Act 1934 and SEC Rule 10b-5

 - The 'disclose or abstain rule'

 - SEC Rule 14e-3

 - 'Misappropriation' theory

 - SEC Rule 10b-5(1) and Rule 10b-5(2)

- Evaluation of the regulation of insider dealing in the US

 - Is the US system preeminent in terms of enforcement?

- The regulation of financial markets in the UK

- The regulation of insider dealing in the UK

 - Company Securities (Insider Dealing) Act 1985

 - Criminal Justice Act 1993 Part V

 - Financial Services and Markets Act 2000

- Evaluation of the current insider dealing regulation in the UK

- Structure and regulation at the Dubai International Financial Centre (DIFC)

 - Structure of the DIFC

- The regulation of insider dealing in the Dubai International Financial Centre (DIFC)

- Evaluation of the DIFC regulatory system

- A comparative perspective of the systems of the US, the UK and the DIFC in regulating insider dealing

 - Regulatory system

 - Clarity of regulations

 - Criminal/civil sanctions

 - International standards

 - The policy of regulation

Introduction

This chapter will look at the US, the UK and the Dubai International Financial Centre (DIFC) explaining the background to and nature of the systems of each. It will examine the general characteristics of the jurisdictions, the main characteristics of the regulatory systems and the characteristics of the rules related to insider dealing. Rather than explaining such regulation, it will scrutinise the background of the regulation of insider dealing in each jurisdiction, aiming to identify the advantages and disadvantages of each system. This chapter argues that looking at the general law to find suitable models for comparison is not useful. Therefore, it discusses three important factors in each jurisdiction: the general characteristics of the jurisdiction, the main characteristics of the regulatory system and the characteristics of the rules related to insider dealing. A brief discussion of these three factors will explain how the regulation of insider dealing has been formed in each jurisdiction.

The chapter will adopt a ‘macro-comparison’ approach to the regulation of insider dealing in the three jurisdictions. This method allows the discussion of the comparative systems in outline in order to understand holistically the background and the nature of the systems. Thus, in each jurisdiction the chapter will look at the structure of the system and the way in which it works, as well as looking at the legislative history. The discussion of each jurisdiction will end with a succinct evaluation of the advantages and disadvantages of the system.

At the end of the chapter there will be a summary of the main points of comparison of the US, UK and DIFC systems for regulating insider dealing. These are classified under the following topics: regulatory system, clarity of regulations, criminal/civil sanctions, international standards and the policy of regulation.

In each system, there are issues that have given rise to academic discussion, since the problems of each system are distinct and unique. This chapter aims to introduce the three systems. However, it concentrates on the problematic issues in each system. It explores especially the history of the regulation of insider dealing and emphasis is given to the difficulties faced in each jurisdiction.

The regulation of financial markets in the US

It is known that the most significant feature of financial regulation in the US is the underlying principle of disclosure. Since the 1930s, the US has worked to provide the leading regulatory system which can protect investors and market participants through information disclosure. Self-regulation traditionally underlies the financial regulation system in the US. Before 1929, there was resistance of federal regulation of the financial markets. Stock exchanges then acted as Self Regulatory Organizations (SROs), regulating their members. The main federal statutory framework was introduced following the financial crisis of 1929; it included the Securities Act 1933, the Securities Exchange Act 1934 and the establishment of the Securities and Exchange Commission (SEC). As a result, much of the authorities were left to SROs to regulate day-to-day activities in securities markets, though, under thorough monitoring by the SEC.¹⁹⁴

It is considered that the federal securities laws mandated the SEC two types of responsibilities. One is administering the system of mandatory disclosure of information and enforcing the antifraud provisions. This task aims at providing information equally for all the investors. The second type of the SEC responsibilities is regulating securities markets. In this regard, the SEC is responsible for regulating securities industry through supervising SROs.¹⁹⁵

The US is a unique and large federal country, so the regulation and supervision of financial markets is conducted by a large number of regulatory bodies. Self-regulation in the US is conducted by exchanges registered with government regulatory bodies such as the SEC. The registered exchanges act as Self-Regulatory Organizations; hence they adopt specific regulations binding exchanges and market participants. These exchanges are also responsible for monitoring compliance with the standards laid down by the rules and regulations.¹⁹⁶

SROs can be exchanges, clearing houses or other organizations. The National Association of Securities Dealers (NASD) is an important SRO with the vital task of supervising the NASDAQ electronic exchange, over-the-counter (OTC) markets and active individuals in securities trading. The NASD makes rules to determine standard trading practices and

¹⁹⁴ ANJALI KUMAR, TERRY M. CHUPPE AND PAULA PERTTUNEN *The Regulation of Non-Bank Financial Institutions: the United States, the European Union and Other Countries* (Washington, D.C.: World Bank, c1997). p.16.

¹⁹⁵ WALTER WERNER 'The SEC as a Market Regulator' (1984) 70 *Virginia Law Review* 755. pp.783-4.

¹⁹⁶ *ibid.*, p.16.

monitors the compliance of brokers and dealers with such standards. The registered exchanges and the NASD as SROs are registered and monitored by federal regulators. Therefore, they are obliged to absorb the federal statutory framework and the rules forwarded by the federal regulators such as Securities and Exchange Commission (SEC) and the Commodity Futures Trading Commission (CFTC).¹⁹⁷

The SEC is a federal regulatory body and was established under the Securities Exchange Act 1934. As a federal governmental authority, it is delegated powers by the US Congress. It is established as a Congressional commission, and thus is required to report regularly to Congress. The SEC is delegated powers to make specific rules under the federal securities acts. It also supervises the participants in the securities industry; securities exchanges, securities brokers and dealers, investment advisors and mutual funds. The supervisory task is directed to assure disclosure of market-related information, maintenance of fair markets and the combating of fraud. For the SEC to meet its supervisory tasks, brokers and dealers have to register with it to obtain permission to deal in securities. The SEC also monitors compliance with regulations in regard to new securities issued. There is a systematic relationship between the SEC and other SROs. The SEC is the primary regulator and supervisor of the US securities markets. Nevertheless, it mandates powers to other SROs. The SEC reserves the right to monitor the mechanism of self-regulation and to maintain compliance with federal securities laws. While the SROs are responsible for setting standards of securities trading conduct, any rules adopted by SROs have to be submitted to the SEC for approval. The SEC also has the power to amend any existing rules.¹⁹⁸

The Commodity Futures Trading Committee (CFTC) is also a federal Congressional commission equivalent to the SEC. The CFTC is delegated by the authorities to regulate and supervise the financial and commodity futures markets. There are also registered SROs specializing in the regulation of commodity futures markets. The mechanism of self-regulation is similar to that applied in securities markets self-regulation.

In addition to the federal commissions and self-regulatory organisations, each state in the US has its own regulatory authority. A state authority is only competent to regulate securities trading within the state, not across states.¹⁹⁹

¹⁹⁷ For a discussion see EDWARD F. GREENE *U.S. Regulation of the International Securities and Derivatives Markets* (New York: Aspen Publishers, 2004). Chapter 1.

¹⁹⁸ *ibid.*, section (1-7). The objectives and powers of the SEC are clearly determined by the Securities Exchange Act 1934.

¹⁹⁹ *ibid.*, section (10-73).

The regulation of insider dealing in the US

It seems that early common law principles were not sufficient to prohibit insiders from dealing in corporate shares without the disclosure of inside information. However, from the 1930s there has been a departure from such principles to complex federal regulation of insider dealing, the influence of which has resulted in the regulation of insider dealing in other countries, though with different legal principles and enforcement levels. It is apparent that the USA has developed a unique body of regulations, depending on extra powers given to the SEC and legal principles drawn from case law.

By ‘early common law’ we mean the decision in *Percival v. Wright*²⁰⁰ which introduced the judicial principle that the director of a corporation is not under a fiduciary duty to shareholders not to use inside corporate information for its own benefit. This was based on the idea that the fiduciary duty of directors was only to the company. This judgment had been influential in common law countries before the introduction of any legislation overruling it. However, common law development in the USA has been stimulated by the legislation. After the stock market crash of 1929 in the United States, Congress promulgated the Securities Act 1933 and the Securities Exchange Act 1934 as methods to restrain abuses and raise accountability.

There are two distinguishable categories of provisions, from the afore-mentioned two acts, that are used to confront the misuse of inside information. The first category which is explicitly directed to prohibit insider dealing is found in Section 16(b) of the Securities and Exchange Act 1934. The second category of provisions which are used in prohibiting insider dealing are in fact provisions against fraudulent means in dealing in securities. These provisions are found in section 17(a) of the Securities Act 1933 and Section 10(b) of the Securities and Exchange Act.

Section 16(b) of the Securities and Exchange Act 1934 and Section 17(a) of the Securities Act 1933

Section 16(b)²⁰¹ is dedicated to the prevention of the unfair use of information by any

²⁰⁰ *Percival v. Wright*, [1902] 2 Ch. 421.

²⁰¹ Securities and Exchange Act 1934, Section 16(b): “Profits from purchase and sale of security within six months”.

For the purpose of preventing the unfair use of information which may have been obtained by such beneficial owner, director, or officer by reason of his relationship to the issuer, any profit realized by him from any purchase and sale, or any sale and purchase, of any equity security of such issuer...involving any such equity security within any period of less than six months,...shall inure to and be recoverable by the issuer, ... Suit to recover such profit may be instituted at law or in equity in any court of competent jurisdiction by the issuer, or by the owner of any security of the issuer in the name and in behalf of the issuer ...”

beneficial owner, director or officer who may have obtained information from the corporation by virtue of his relationship to the corporation. Thus, this section makes illegal, except in very limited situations, any profits made in any period of less than six months (the period between sale and purchase or purchase and sale) by any directors, officers and principal holders (holders of more than 10%) from dealing in the stock of their corporation. An insider who breaches this section is strictly liable to the issuer, since the latter can bring a suit against the insider to recover the profits made.

It is apparent that Section 16(b) is a limited provision, as it is aimed at preventing dealing by those insiders most likely to have access to important corporate information. There have been attempts to extend the term ‘beneficial ownership’, so the insider is deemed to be the ‘beneficial owner’ of shares owned by individuals close to him. The problem has been in determining the limits of ‘beneficial ownership’, where dealing in the stock of the insider’s corporation is not done by the insider himself but by persons close to him; for example, partners and family members. Attempts have been directed to holding the insider liable in such situations even if the dealing is not made in his own name. Such attempts were justified on the basis of considering the close person as an ‘alter-ego’ for the insider, who is thought to be a direct or indirect beneficiary. In *Whiting v. Dow Chemical Co.*,²⁰² Mr. Whiting was an insider to the company Dow Chemical Co. His wife Mrs. Whiting sold some shares of the Dow Corporation during September and November of 1973. This was followed by Mr. Whiting dealing in stock option granted to him by the company. The court found Mr. Whiting liable under Section 16 (b) since he had received direct benefit from his wife’s dealing in stocks. The judgment was based on the ground that Mrs. Whiting was an ‘alter-ego’ for Mr. Whiting who in turn benefited from his wife’s dealings even if the dealings were not in his own name.²⁰³

Nevertheless, it is reasoned that the term ‘beneficial owners’ should be narrowly interpreted.²⁰⁴ The arguments are the history of legislation, underlying policies and Supreme Court interpretations. Section 16(b) was introduced to function only in a limited purpose; this is supported by the deletion of ‘tippee liability’ from this section. Such liability was to hold the tippee liable to the corporation for any profits made in six months from the disclosure of inside information to him. This deletion indicates that the purpose of

²⁰² *Whiting v. Dow Chemical Co.* 386 F. Supp. 1130(S.D.N.Y. 1974), *aff’d*, 523 F.2d 680 (2d Cir. 1975).

²⁰³ *Whiting v. Dow Chemical Co.* 386 F. Supp. at 1137.

²⁰⁴ RICHARD S. LINCER, “‘Beneficial Ownership’ under Section 16(b) of the Securities Exchange Act of 1943’ (1977) 77 *Columbia Law Review* 446. pp.448-64.

introducing Section 16(b) was to make it limited in scope and to make strict liability arise automatically when the section is breached.²⁰⁵ The Supreme Court in *Blau v. Lehman*²⁰⁶ confronted the scope of the term ‘beneficial ownership’, but it declined to extend Section 16(b) beyond the determined scope embodied by the explicit language of the statute.

The Securities Act 1933, section 17(a) contains a provision which prohibits fraudulent means, material misstatement and omission to state material facts in the *sale* of securities. This provision is limited to deceptive *selling* during the process of distribution of shares. Other provisions against insider dealing after the distribution of shares are found in the more specialised Securities Exchange Act 1934.²⁰⁷

Section 10(b) of the Securities and Exchange Act 1934 and SEC Rule 10b-5

The main provision used against insider dealing is found in Section 10(b) of the Securities Exchange Act 1934. This section makes 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” .²⁰⁸

The SEC promulgated rule 10b-5 to implement the above section. This rule states that: “It shall be unlawful for any person, directly or indirectly . . . ,

- (a) to employ any device, scheme, or artifice to defraud,
- (b) to make any untrue statement of a material fact or omit to state a material fact necessary in order to make the statements made, in 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 a security” .

It is apparent that these broad anti-fraud provisions are explicitly directed to prohibit fraud and misrepresentation in dealing in securities. On the other hand they make no direct

²⁰⁵ *ibid.*, p.450.

²⁰⁶ *Blau v. Lehman* 368 U.S. 403 (1962).

²⁰⁷ LOUIS LOSS ‘The Fiduciary Concept as applied to trading by corporate “insiders” in the United States’ (1970) 33 *Modern Law Review* 34. p.41.

²⁰⁸ Securities Exchange Act 1934, revised through September 30, 2004.

indication to insider dealing. This is the point where the SEC and the courts have filled the legislative gap, by exercising their authority to reach the important administrative and judicial precedents, respectively, prohibiting insider dealing. In this regard the vagueness of the anti-fraud provisions was propounded by the attitude to prohibit insider dealing. The anti-fraud provisions were of an ambiguous nature, and while this may be considered as flexibility in order to leave room for much interpretation to meet new contrivances, at the same time it is a controversial legal method which was broadly interpreted under the ethical demand for prohibiting insider dealing.²⁰⁹

The anti-fraud provisions were rather easily interpreted as being applicable to corporate insiders who secretly deal in their own corporation's stock whilst in possession of inside information. In such cases there is a legal acceptance of corporate insider's liability under the basis of fraud. The difficulty remained whether Section 10(b) and Rule 10b-5 could be extended to held liable 'corporate outsiders' for dealing while in possession of inside information.

The 'disclose or abstain rule'

There was a trend to extend liability under section 10(b) to include 'corporate outsiders' or 'tippees'. This line of argument was supported by the fact that the Securities Act 1933 and the Securities Exchange Act 1943 were promulgated to confront the type of misconduct which contributed to the collapse in 1929. In particular, the Securities Exchange Act 1943 aimed at putting investors on an equal footing in terms of access to corporate information.²¹⁰ The SEC was in favour of this line of reasoning. In the crucial case of *In re Cady Roberts & Co.*,²¹¹ the SEC held that the provisions of insider dealing do extend to the prohibition of 'corporate outsiders' from insider dealing. The case was against a broker who was informed by an associate in a firm, who was also a director of the issuer of the related security, of a dividend reduction in relation to the security. The broker, while in possession of the information which had not yet been disclosed to the public, dealt for discretionary accounts in the related security. In this case the SEC held that a broker, who traded while in possession of non-public information passed to him, is liable under Rule

²⁰⁹ THOMAS C. NEWKIRK AND MELISSA A. ROBERTSON, *Speech by SEC Staff: Insider Trading – A U.S. Perspective*, 16th International Symposium on Economic Crime, Jesus College, Cambridge, England, 19 September, 1998. p.4.

²¹⁰ Comment 'Deterrence of Tippee Trading under Rule 10b-5' (1971) 38 *The University of Chicago Law Review* 372. p.375.

²¹¹ *In re Cady Roberts & Co.* 40 SEC 907 (1961).

10b-5. The SEC justified such a decision on the ground that the duty or obligation of corporate insiders could be extended to those outside the corporation in certain circumstances. It appears that the legal basis was the ‘disclose or abstain rule’ which is in part based on equality of information. According to this rule there can be ‘temporary’ or ‘constructive’ insiders who possess material non-public information. They have to disclose such information or abstain from dealing until the information made public. The underlying premise on which the SEC justified the ‘disclose or abstain’ rule was that the major purpose of the Securities Acts was the prevention of fraud, manipulation or deception in connection with securities transaction. On this line of reasoning, the SEC extended liability under Rule 10b-5.²¹²

The SEC ruling in *Cady* was supported by a federal circuit court in the case *SEC v. Texas Gulf Sulphur Co.*²¹³ In this case the SEC filed a complaint against Texas Gulf Sulphur Company and thirteen of its officers, directors and employees for violating Rule 10b-5. The drilling operations of the company resulted in a discovery of a rich ore body. The company tried to conceal the discovery. Following the discovery, the defendants dealt in the related securities, received options to buy securities and disclosed information related to the discovery to others who also dealt in securities. All these actions of the defendants occurred while they knew the material non-public information considering the discovery. The court based its opinion on the premise that Rule 10b-5 is based in policy on the principle that all investors trading on marketplace should have relatively equal access to material information.²¹⁴ The court embraced the SEC reasoning in the case of *Cady*. Thus, it decided that anyone who possesses inside information is obliged either to disclose it or abstain from dealing with respect to the information known. The court reasoned that anyone who deals while advantaged by inside information is acting fraudulently in regards to the interests of other buyers and sellers.²¹⁵

In the 1980s the courts narrowed the scope of Section 10(b) and Rule 10b-5. The ‘disclose or abstain’ rule adopted by the SEC and supported by lower courts was rejected by the

²¹² *In re Cady Roberts & Co.* 40 SEC 907 (1961). p.910. The position of the SEC is discussed in more depth by DONALD C. LANGEVOORT ‘Rereading “Cady, Roberts”’: The Ideology and Practice of Insider Dealing Regulation’ (1999) 99 *Columbia Law Review* 1319. pp.1319-31.

²¹³ *SEC v. Texas Gulf Sulphur Co.*, 401 F.2d 833 (2d Cir. 1968), cert. denied, 394 U.S. 976 (1969). For background for the case in more details WILLIAM H. PAINTER ‘Inside Information: Growing Pains for the Development of Federal Corporation Law under Rule 10b-5’ (1965) 65 *Columbia Law Review* 1361.

²¹⁴ *SEC v. Texas Gulf Sulphur Co.*, 401 F.2d 833 (2d Cir. 1968), cert. denied, 394 U.S. 976 (1969). at 848.

²¹⁵ *ibid.*, at 848.

Supreme Court. In 1980 in the case *Chiarella v. United States*,²¹⁶ the Supreme Court of the United States decided that a printer handling corporate takeover bids who deduced the identities of the companies and dealt in their stock without disclosing information about the takeovers, was held not to have violated Section 10(b) and Rule 10b-5. The financial printer was prosecuted on the grounds that he used information regarding tender offers and a merger, and bought stocks in the targeted companies. The Supreme Court reversed the conviction holding that dealing on the basis of material non-public information in itself is not a breach of the anti-fraud provisions and the printer was not obliged to a duty of disclosure to the target shareholders. The court rather embraced the idea that the liability under Rule 10b-5 is premised on the duty to disclose arising from a relationship of trust and confidence.²¹⁷ However, from this case emerged a visionary opinion of Chief Justice Burger who dissented on the ground that he would have upheld the conviction depending on whether the defendant had ‘misappropriated’ information confidentially passed to him by his employer, and used it for his personal benefit.²¹⁸ The opinion provided a basis for later adopting the theory of ‘misappropriation’.

SEC Rule 14e-3

The instant response of the SEC to *Chiarella* was the adoption of Rule 14e-3²¹⁹ under Section 14(e) of the Securities and Exchange Act 1934. The rule was designed to prohibit insiders of the offeror and the target from revealing material information about a tender offer to those who are to be expected to trade on the basis of such information. The rule also prohibits those ‘outsiders’ who possess material information regarding a tender offer

²¹⁶ *Chiarella v. United States*, 445 U.S. 222 (1980). More in depth explanation of the case in DONALD C. LANGEVOORT ‘Insider Trading and the Fiduciary Principle: A Post-Chiarella Restatement’ (1982) 70 *California Law Review* 1. pp.11-6.

²¹⁷ *Chiarella v. United States*, 445 U.S. 222 (1980). at 230.

²¹⁸ *ibid.*, at 341.

²¹⁹ Rule 14e-3 “Transactions in Securities on the Basis of Material, Nonpublic Information in the Context of Tender Offers

If any person has taken a substantial step or steps to commence, or has commenced, a tender offer (the "offering person"), it shall constitute a fraudulent, deceptive or manipulative act or practice within the meaning of section 14(e) of the Act for any other person who is in possession of material information relating to such tender offer which information he knows or has reason to know is nonpublic and which he knows or has reason to know has been acquired directly or indirectly from:

The offering person,

The issuer of the securities sought or to be sought by such tender offer, or

Any officer, director, partner or employee or any other person acting on behalf of the offering person or such issuer, to purchase or sell or cause to be purchased or sold any of such securities or any securities convertible into or exchangeable for any such securities or any option or right to obtain or to dispose of any of the foregoing securities, unless within a reasonable time prior to any purchase or sale such information and its source are publicly disclosed by press release or otherwise...”.

by another person from dealing in the target company's securities. In this case though, the prohibition emerges if the bidder commenced or has taken substantial steps in the commencement of the bid. It is apparent that the scope of the rule is limited to information related to a tender offer. Moreover, outsiders' dealing in the target company's securities while in possession of material information is only prohibited when the offeror has taken substantial steps in the commencement of the offer.²²⁰

'Misappropriation' theory

Following *Chiarella*, courts in the US at different levels were confronted by the controversies of the 'misappropriation theory'. According to this theory, 'corporate outsiders' possessing inside information violate Rule 10b-5 if they deal, because their act is a misappropriation of the information they receive through a relationship of trust or confidentiality. Due to differing views of the misappropriation theory, there was a split between circuit courts. There was also a split between Justices in the Supreme Court regarding the theory.²²¹ For the purpose of our study, we investigate the cases of the Supreme Court and only the important cases at circuit level.

In 1981 the Second Circuit adopted the 'misappropriation' theory in the case of *United States v. Newman*.²²² It was held that a person may be liable under Rule 10b-5 for dealing while in possession of information obtained in breach of a confidential and trust-bound relationship. The defendant was held liable due to dealing in securities while in possession of material non-public information concerning corporate takeovers that was passed to him by two investment bankers. Although the defendant as an 'outsider' was not under a fiduciary duty towards the shareholders, he was convicted of 'misappropriating' inside information.

Three years later there was another significant judicial decision by the Supreme Court in *Dirks v. SEC*.²²³ A case in which an officer of a brokerage firm received information from

²²⁰ BAINBRIDGE STEPHEN 'Insider Trading' in *Encyclopedia of Law and Economics III* (Cheltenham, U.K.: Edward Elgar Publishing, 2000). p.775.

²²¹ The misappropriation theory was rejected by the Fourth Circuit in *United States v. Bryan*, 58 F.3d 933, 949 (4th Cir. 1995). It was also rejected by the Eighth Circuit in *United States v. O'Hagan*, 92 F.3d 612 (8th Cir. 1996); however, the Supreme Court reversed the decision. The theory was accepted by the Second, Third, Seventh and Ninth Circuits in the cases respectively, *United States v. Newman*, 664 F.2d 12, 16-17 (2d Cir. 1981); *Rothberg v. Rosenbloom*, 771 F.2d 818, 822 (3d Cir. 1985); *SEC v. Cherif*, 933 F.2d 403, 410 (7th Cir. 1991); *SEC v. Clark*, 915 F.2d 439, 449-50 (9th Cir. 1990). See JONATHAN E. A. TEN OEVER 'Insider trading and the Dual Role of Information' (1997) 106 *The Yale Law Journal* 1325. p.1325.

²²² *UNITED STATES v. Newman*, 664 F.2d 12 (2d Cir. 1981).

²²³ *Dirks v. SEC*, 463 U.S. 646 (1983).

insiders of a corporation whose assets were said to be overstated as a result of fraudulent practices. The officer discussed the information with a number of his clients who sold their shares in accordance with the information they received. The officer also tried to persuade a newspaper to write about the allegations but they refused. Consequently dealing in the corporation's securities was halted after its fall. Thereafter, evidence of fraud in the corporation was uncovered and made public. The SEC investigated the officer's role and decided to censure him. The Supreme Court reversed the SEC's decision holding that a tippee of material non-public information has not violated the federal securities laws by passing allegations of fraud to investors.

Dirks was considerable because it addressed at the time the question of the liability of 'tipper and tippee'.²²⁴ It was held that tippees are liable if they knew or had reason to believe that the tipper violated a fiduciary relationship and the tipper received direct or indirect benefit from this breach. In *Dirks* the tippees were held not liable because their tipper received no personal benefit from disclosing the information. The Supreme Court in this decision added a new controversial condition to liability in requesting 'receipt of monetary or personal benefit for revealing the information', a requirement which was dissented by Blackmun, J., joined by Brennan and Marshall, JJ. as being with no basis in law or policy.²²⁵ Another important feature of the Supreme Court decision in *Dirks* was the opinion of Justice Powell in footnote 14. He explained the concept of 'constructive insiders' as those who legitimately receive information as underwriters, lawyers, consultants and others. These 'constructive insiders' may become fiduciaries not simply because they possess non-public corporate information, but rather because they entered a special confidential relationship. A condition for such an obligation is that the corporation must expect the outsider 'constructive insider' to keep the information confidential. In this opinion when such a person violates his fiduciary relationship he may be treated as a tipper rather than a tippee.²²⁶

The misappropriation theory was again questioned in the Second Circuit in *United States v. Carpenter*,²²⁷ a case of a columnist for the Wall Street Journal whose columns were significant in affecting stock prices. He tipped the information in his forthcoming column to

²²⁴ DONALD C. LANGEVOORT 'Investment Analysis and the Law of Insider Trading' (1990) 76 *Virginia Law Review* 1023. pp.1032-1033.

²²⁵ *Dirks v. SEC*, 463 U.S. 646 (1983). at 668.

²²⁶ *ibid.*, n14.

²²⁷ *UNITED STATES v. Carpenter*, 791 F.2d 1024 (2d Cir. 1986), on appeal 484 U.S. 19 (1987).

a broker dealer in order to share profits made by the advantageous knowledge. The columnist was convicted of fraud under Rule 10b-5, and mail and wire fraud. The Second Circuit rejected the defendant's argument that misappropriation theory is only valid to the conduct of corporate or constructive insiders; it perceived misappropriation as conversion of material non-public information by insiders or 'others' in dealing in securities. On appeal the Supreme Court did not answer the validity of the misappropriation theory when it was divided four by four on the convictions under Section 10-b. The mail and wire fraud convictions were affirmed. The Court issued no written opinion about misappropriation theory, thus, from this case it is indiscernible whether they entirely rejected the theory or they rejected applying it to the facts in *Carpenter*.²²⁸

The misappropriation theory and the scope of insider dealing prohibition were again questioned in the case of the *United States v. Bryan*.²²⁹ In this case the director of West Virginia Lottery used his position for the award of two big contracts. He was convicted of mail fraud and securities fraud for trading, while in possession of non-public information, in securities of companies to which he had given contracts. On appeal, the Fourth Circuit held that the securities fraud charge could not be sustained because its basis, 'the misappropriation theory', is invalid, since it is not complementary to "the language of Section 10(b), Rule 10b-5, the Supreme Court authority interpreting these provisions and the purposes of these securities fraud prohibitions".²³⁰ In its reasoning the Court depended on the statute's text and to a subsidiary extent on its purposes.²³¹ Considering the textual language, the Court reasoned that misappropriating information in most cases does not involve 'deception' as required by Section 10(b). Misappropriation of information constitutes neither 'misrepresentation' nor 'non-disclosure'. Moreover as the theory does not require deception, it raises liability upon the breach of a fiduciary or trust and confidential relationship. Furthermore, the theory does not complement the Section 10(b) requirement that the conduct be "in connection with" the purchase or sale of securities. The conduct of misappropriating information from its source is likely to have no connection with the purchase or sale of securities. This is apparent in a case similar to *Bryan*, where the

²²⁸ *UNITED STATES v. Carpenter*, 791 F.2d 1024 (2d Cir. 1986), on appeal 484 U.S. 19 (1987). Explained in LOUIS LOSS AND JOEL SELIGMAN (eds.) *Fundamentals of Securities Regulation* (New York 5th ed.: Aspen Publishers, c2004). p.1014.

²²⁹ *UNITED STATES v. Bryan*, 58 F.3d 933 (4th Cir. 1995).

²³⁰ *ibid.*, at 944.

²³¹ Review 'Securities Law. Insider trading. Fourth Circuit Rejects Misappropriation Theory of Rule 10b-5 Fraud Liability. *United States v. Bryan*, 58 F.3d 933 (4th Cir. 1995)' (1995) 109 *Harvard Law Review* 536. P.537.

source of misappropriated material non-public information is not a purchaser or seller, and not connected or interested in the purchase or sale of securities.²³² The Court in addition criticized the misappropriation theory on policy grounds in that it fails to afford a basis for distinguishing which types of fiduciary, trust and confidential relationships can raise liability under Rule 10b-5.²³³

The reasoning of *Bryan* directs the attention to the affiliation between the misappropriation theory, the text of Section 10(b) and the Supreme Court precedent. The broad language of Section 10(b) and its intended limited purpose makes it difficult to marry it to the misappropriation theory. However, the Court disregarded the role of other courts in drawing the scope and purposes of the rule.²³⁴

The argument for expanding the anti-fraud provisions in accordance with misappropriation theory witnessed its victory when the Supreme Court reversed the decision of an Eight Circuit judgment in the case of *United States v. O'Hagan*.²³⁵ O'Hagan was a partner in Dorsey and Whitney, a law firm which represented Grand Metropolitan PLC with regards to a potential tender offer for the Pillsbury Company's common stock. O'Hagan did no work in the representation, but he learned of the potential deal and began acquiring call options in Pillsbury stock which he sold at a profit of more than \$ 4.3 million when Grand Met made public its tender offer and the price of Pillsbury stock rose considerably. O'Hagan argued that his conduct did not amount to fraud because he owed no fiduciary relationship to Pillsbury. The Supreme Court rejected his contention and upheld his conviction. The Court explicitly adopted misappropriation theory in its words "under the complementary "misappropriation theory", urged on by the Government in this case. A corporate "outsider" violates Section 10(b) and Rule 10b-5 when he misappropriates confidential information for securities trading purposes, in breach of a fiduciary duty owed to the source of the information, rather than to the persons with whom he trades".²³⁶

The Court reasoned that misappropriation meets the statutory requirement that the conduct be deceptive. There is deception in non-disclosure of trading activity to the source of information by the misappropriator. The Court in addition reasoned that the requirement of Section 10(b) that the deception shall be in connection with the purchase or sale of

²³² *UNITED STATES v. Bryan*, 58 F.3d 933 (4th Cir. 1995). at 537-8.

²³³ *UNITED STATES v. Bryan*, 58 F.3d 933 (4th Cir. 1995). at 538.

²³⁴ *ibid.*, at 537-8, at 538.

²³⁵ *UNITED STATES v. O'Hagan*, 92 F.3d 612 (8th Cir. 1996). In the Supreme Court *United States v. O'Hagan*, 117 S.Ct. 2199, 2211 (1997).

²³⁶ *United States v. O'Hagan*, 117 S.Ct. 2199, 2211 (1997). at 2209.

securities is met, since the misappropriator commits fraud not when he obtains non-public information, but when he uses the information in dealing in securities. Though the person or entity deceived is not the other party in the deal, but is rather the source of the non-public information. The Court accepted the rationale of ‘treating information as property’ in stating that a company’s confidential information qualifies as property on which the company holds a right of exclusive use and its misappropriation is identical to misappropriating goods or money entrusted to one’s care.²³⁷

O’Hagan was a victory for the SEC, allowing it to extend liability under Rule 10b-5. Since *O’Hagan*, the misappropriation theory has been considered a valid ground to extend the scope of prohibiting insider dealing. However, it is still true that case law has gone far in expanding Rule 10b-5. It is argued with reason that the misappropriation theory does not comport with the language or with the legislative purpose of Section 10b. In this sense, the misappropriation theory repeated the same problem of the ‘disclose or abstain’ rule. In *Chiarella*, the ‘disclose or abstain’ rule was rejected because neither the language of Section 10b nor the legislative history corresponded to such a broad duty as represented by this rule.²³⁸

SEC Rule 10b-5(1) and Rule 10b-5(2)

There have been other problems in depending on case law to apply Rule 10b-5 on insider dealing. One issue that confronted the courts was whether Section 10b and Rule 10b-5 required that the insider *use* the inside information or whether the mere *possession* of inside information would be sufficient to hold him or her liable. The Ninth and Eleventh Circuits held that *possession* is not sufficient to hold someone liable under Section 10b and Rule 10b-5.²³⁹

The SEC responded to the problem of *possession* versus *use* of inside information by adopting Rule 10b-5(1) in 2000.²⁴⁰ The new rule provided a definition of “on the basis”. It

²³⁷ *United States v. O’Hagan*, 117 S.Ct. 2199, 2211 (1997). at 2208.

²³⁸ RICHARD W. PAINTER; KIMBERLY D. KRAWIEC AND CYNTHIA A. WILLIAMS ‘Don’t Ask, Just Tell: Insider Trading after *United States v. O’Hagan*’ (1998) 84 *Virginia Law Review* 153. p.188.

²³⁹ *United States v. Smith*, 155 F.3d 1051, 1069 (9th Cir. 1998), c d. *denied*, 119 S. Ct. 804 (1999) and *SEC v. Adler*, 137 F.3d 1325, 1337 (11th Cir. 1998). See KAREN SCHOEN ‘Insider Trading: The “Possession versus Use” Debate’ (1999) 148 *University of Pennsylvania Law Review* 239.

²⁴⁰ Rule 10b5(1) “Trading “on the Basis of” Material Nonpublic Information in Insider Trading Cases”.

Preliminary Note to Rule 10b5-1: This provision defines when a purchase or sale constitutes trading “on the basis of” material nonpublic information in insider trading cases brought under Section 10(b) of the Act and

states that dealing while being ‘aware’ of the material non-public information is sufficient for a dealer to be considered liable to insider dealing under Rule 10b-5. A person dealing has an affirmative defence if he/she demonstrates that before becoming aware of the information, he/she had entered into a contract, instructed another person to purchase or sell the security for the instructing person’s account or adopted a written plan for trading securities.

Another landmark ruling occurred when the SEC adopted Rule 10b-5(2).²⁴¹ This rule provides a non-exclusive definition of circumstances in which a person has a duty of trust or confidence for the purpose of the “misappropriation” theory. According to this rule, a duty of trust or confidence exists in three non-exclusive situations: 1) whenever a person agrees to maintain information in confidence, 2) whenever the person communicating the

Rule 10b-5 thereunder. The law of insider trading is otherwise defined by judicial opinions construing Rule 10b-5, and Rule 10b5-1 does not modify the scope of insider trading law in any other respect.

a. General. The "manipulative and deceptive devices" prohibited by Section 10(b) of the Act and Rule 10b-5 thereunder include, among other things, the purchase or sale of a security of any issuer, on the basis of material nonpublic information about that security or issuer, in breach of a duty of trust or confidence that 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 nonpublic information.

b. *Definition of “on the basis of.”* Subject to the affirmative defenses in paragraph (c) of this section, a purchase or sale of a security of an issuer is "on the basis of" material nonpublic information about that security or issuer if the person making the purchase or sale was aware of the material nonpublic information when the person made the purchase or sale.

...”

²⁴¹ Rule 10b5-2: “Duties of Trust or Confidence in Misappropriation Insider Trading Cases”.

Preliminary Note to § 240.10b5-2: This section provides a non-exclusive definition of circumstances in which a person has a duty of trust or confidence for purposes of the "misappropriation" theory of insider trading under Section 10(b) of the Act and Rule 10b-5. The law of insider trading is otherwise defined by judicial opinions construing Rule 10b-5, and Rule 10b5-2 does not modify the scope of insider trading law in any other respect.

a. *Scope of Rule.* This section shall apply to any violation of Section 10(b) of the Act and Rule 10b-5 thereunder that is based on the purchase or sale of securities on the basis of, or the communication of, material nonpublic information misappropriated in breach of a duty of trust or confidence.

b. *Enumerated “duties of trust or confidence.”* For purposes of this section, a "duty of trust or confidence" exists in the following circumstances, among others:

1. Whenever a person agrees to maintain information in confidence;
2. Whenever the person communicating the material nonpublic information and the person to whom it is communicated have a history, pattern, or practice of sharing confidences, such that the recipient of the information knows or reasonably should know that the person communicating the material nonpublic information expects that the recipient will maintain its confidentiality; or
3. Whenever a person receives or obtains material nonpublic information from his or her spouse, parent, child, or sibling; provided, however, that the person receiving or obtaining the information may demonstrate that no duty of trust or confidence existed with respect to the information, by establishing that he or she neither knew nor reasonably should have known that the person who was the source of the information expected that the person would keep the information confidential, because of the parties' history, pattern, or practice of sharing and maintaining confidences, and because there was no agreement or understanding to maintain the confidentiality of the information.”

material non-public information and the person to whom it is communicated have a history of sharing confidences and this history indicates an expectation of confidentiality, or 3) whenever a person receives material non-public information from his or her spouse, parent, child, or sibling.

Evaluation of the regulation of insider dealing in the US

The discussion of the regulation of insider dealing in the US raises the question of the desirability of defining the standard and scope for insider dealing liability.²⁴² The SEC only attempted to adopt secondary definitions in relation to insider dealing. The SEC decided to publish clearly defined rules when it adopted Rule 14e-3, which aims to prohibit anyone other than a tender offeror or its affiliate from purchasing securities while in possession of material non-public information regarding the tender offer. The SEC adopted Rule 10b-5(1) defining when trading is considered “on the basis of” material non-public information. It also adopted Rule 10b-5(2) defining duties of trust or confidence in misappropriation insider trading cases.

Two of the best scholars in the field, Loss and Seligman, responded more than a decade ago, indicating that:

With full appreciation of the advantages of the common law’s ad hoc approach, it still seems clear that the jurisprudence on trading while in possession of material non-public information has developed to the point where it cries out for the kind of philosophic consistency that only studied legislation can provide.²⁴³

It seems that the law-making process has been one of avoiding a precise determination of insider dealing regulation by statutory law. The degree of dependence on the interpretation of the antifraud rule, a method that still has legal shortcomings, is also astonishing.

Langevoort thinks that it is no longer a convincing argument to say that defining ‘insider dealing’ would be under-inclusive and would allow opportunists to escape liability. Any rules introduced would provide general standards, not answers to every possible problem. Beyond this, legal thought would more easily apply the legal standards to any given facts.

²⁴² THOMAS LEE HAZEN ‘Defining Illegal Insider Trading: Lessons from the European Community Directive on Insider Trading’ (1992) 55 *Law and Contemporary Problems, International Regulatory Competition and the Securities Laws* 231. p.235.

²⁴³ LOUIS LOSS AND JOEL SELIGMAN *Securities Regulation* (Boston 3rd ed.: Little Brown and Co, 1993). p.3762.

Moreover, taking into account the long experience of the SEC in dealing with the problem, it can avoid shortcomings in introduced rules.²⁴⁴

The avoidance of clarity through statutory rules is thought to be a result of possible objections to the details. Such objections would be raised from the SEC itself if the rules were under-inclusive. The corporate community benefits from insider dealing and so would object to further regulation. Thus, it is thought that the SEC benefited from the vagueness of Rule 10b-5 by attempting to expand the scope of liability on the basis of the purpose of the rule rather than on the basis of its language. According to Langevoort, for the SEC, expanding the interpretation of Rule 10b-5 has been easier than any possible political confrontation to introduce clear rules would have been.²⁴⁵

One of the supposed obstacles to introducing clear rules is the debate on federalism. The trend of federalism supports transferring powers to federal governments to displace the state as the main corporate regulator. The argument in favour of federalism presupposes that a federal government is better at setting standards of managerial conduct because it is free from the laxity caused by competition between states.²⁴⁶ It is indicated that the SEC as a federal regulatory body has attempted to expand the interpretation of Rule 10-b5, depending on the general trend of federal securities regulation, to give it a wider scope. It is thought that the SEC efforts have influenced the judicial precedents of Rule 10b-5. Such influence is apparent in the current misappropriation theory, which represents a wide interpretation of Rule 10b-5. Therefore, it can be said that the SEC has responded to the difficulty of introducing new federal statutes by benefiting from the vagueness of Section 10b and Rule 10b-5.

Is the US system pre-eminent in terms of enforcement?

This discussion of the regulation of insider dealing in the US concentrates on the judicial and administrative interpretation of Rule 10b-5. It can be said that the law of insider dealing in the US has been uncertain and similar cases have been handled in different ways. However, especially in the area of enforcement, the US regime is argued to be efficient. It is said that compared to other developed jurisdictions, the effective enforcement of insider dealing regulation has been an advantage of the US regime. This is attributed to the SEC as

²⁴⁴ DONALD C. LANGEVOORT 'Rereading "Cady, Roberts": The Ideology and Practice of Insider Trading Regulation' (1999) 99 *Columbia Law Review* 1319. pp.1337-8.

²⁴⁵ *ibid.*, p.1339.

²⁴⁶ MICHAEL P. DOOLEY 'Enforcement of Insider Trading Restrictions' (1980) 66 *Virginia Law Review* 1. pp.59-60.

a capable regulator in terms of authority, personnel and resources. The number of successful prosecutions in the US is high compared to that in any other jurisdictions. For example, the SEC brought 40 cases in 2000, 57 cases in 2001 and 59 in 2002.²⁴⁷ Nevertheless, it can be argued that the number of successful cases seems small in comparison with the number of shares traded or number of transactions in the US financial markets, since the US financial markets are the leading markets of the world in terms of capital, volume of trading, number of financial instruments traded, number of transactions. We attempted to compare the number of successful transactions and the number of shares traded in the NASDAQ. The results show that the approximate numbers of shares traded in the NASDAQ were 20 billion in the year 2000, 16 billion in 2001 and 16 billion in 2002.²⁴⁸ This means that there was 1 successful case of insider dealing out of 500 million shares traded in the year 2000, 1 out of 280 million in 2001 and 1 out of 270 million in 2002. However, this comparison could be invalid for more than one reason. The NASDAQ, although the largest, is still only one of several markets in the US. Moreover, the number of shares traded may vary considerably from one year to another. In the year 2000 there was a bubble in the markets of the US, so the number of shares traded was extremely high. Furthermore, a valid comparison would be between the number of successful cases and the actual number of insider dealing activities. The latter, however, is an unknown dark number. Everything considered, it can be said that the proposition that the US has the best record in bringing successful insider dealing cases should not be taken for granted. This number seems rather small if compared to the size of financial markets in the US.

²⁴⁷ EDWARD F GREENE 'United States' in M. STAMP AND T. JAGGERS (eds.) *International Insider Dealing* (Old Woking: City & Financial Publ., c2005). In part, the high number of successful prosecutions is due to the fact that defendants prefer settling SEC charges to avoid more costs of litigation.

²⁴⁸ Source: Yahoo Finance, NASDAQ trading volume. See <<http://finance.yahoo.com>>.

The regulation of financial markets in the UK

For a long time, the financial industry in the UK had been based on self-regulation by exchanges, especially the rules of The Stock Exchange. The government's role was to introduce the legal framework, which in most cases contained general provisions and which were not dedicated to financial markets only. Governmental intervention was limited and reserved for situations thought to protect the public interest. The most important reforms of the regulatory system were in 1986 and 1997. In both cases the reforms were national initiatives not of EU origin as an impetus for reform.

The 1980s experienced new developments in the financial sector, in a trend necessitated by a corresponding change in financial regulation. The concept of the internationalization of financial markets surfaced as a result of new economic liberation concepts, lessening governmental barriers and increasing international financial co-ordination. This period also experienced a number of financial scandals in the UK, at a time when the government policy was to encourage privatization and individual participation. All these resulted in a rapid reformation of the financial industry called "Big Bang".²⁴⁹ The most important feature of 'Big Bang' was the transformation of the regulation of the financial system into a more statute-based activity, through the introduction of The Financial Services Act 1986 (FSA 1986). The main competent authority established under FSA 1986 was the Securities and Investment Board (SIB). The SIB was practically a self-standing commission entrusted with the task of recognizing and monitoring self-regulatory organizations (SROs). At the time, the main self-regulatory organizations (SROs) were delegated powers to monitor respective markets.

The significant changes in the 1980s did not cover the fundamentals of self-regulation. However, the following period proved that SROs worked with evident supervisory deficiencies. The most obvious deficiency was that there was decentralization of the regulatory powers and the responsibilities of the SROs were undetermined, causing an overlap in some areas of responsibility. This resulted in laxity in the SROs. Provided that they were funded by members, they competed with each other to increase membership.²⁵⁰ All these deficits made it clear that the system needed to be reformed.

²⁴⁹ For a detailed discussion of 'big bang' transformation see; L. C. B. GOWER "Big Bang" and City Regulation' (1988) 51 *The Modern Law Review* 1.

²⁵⁰ See PETER HOWELLS AND KEITH BAIN, *Financial Markets and Institutions* (London 2nd: Longman, 1994).

The UK experienced further reform of the financial regulation system in 1997. The predominant principle underpinning the new reforms was an emphasis on statutory regulation. Beneath this principle the Financial Services Authority (FSA) was created to replace the SIB from 1st June 1998. One main reason for establishing the FSA was to have a powerful statutory body responsible for investigating and prosecuting market and insider dealing. It was also planned that the FSA will be delegated powers to impose civil/administrative fines in addition to the power to bring criminal prosecutions.²⁵¹

The FSA did not receive all its powers immediately. The SROs maintained some of their regulatory duties until the end of 2001, when they were transferred to the FSA. The FSA was delegated its comprehensive current powers by the Financial Service and Markets Act (FSMA) 2000. This Act described four regulatory objectives for the FSA: the creation and maintenance of market confidence, public awareness, consumer protection and combating financial crime. Thus, the current era of financial regulation in the UK is characterized as statutory based, and one which delegates regulatory and supervisory powers to a governmental authority, namely the FSA.

The FSA gained extra powers to meet the financial policy of the country. The Bank of England Act 1998 transferred to it the responsibility for supervising the banking system. The FSA has also been responsible for regulating the mortgage market since autumn 2004. In addition, since January 2005 the FSA has been responsible for supervising general insurance business. Therefore, this authority is considered a unique financial regulator, supervising various sectors engaged in the financial industry. In addition to its comprehensive powers, the FSA employs the expertise of market participants through involving them in the consultation and decision making processes. This method ensures that the advantage of the former self-regulatory system in utilizing market expertise is absorbed.²⁵²

²⁵¹ JAMES BAGGE 'The Future for Enforcement under the New Financial Services Authority' (1998) 19 *Company Lawyer* 194. p.194. Also EDITORIAL 'The FSA as a Criminal Enforcer' (2001) 22 *Company Lawyer* 97.

²⁵² DEUTSCHE BUNDESBANK 'Securities Market Regulation: International Approaches' Monthly Report, January 2006. p.44.

The regulation of insider dealing in the UK

Insider dealing activity is not a new issue. There are, especially in the UK, many indications that the practice is as old as the Stock Exchange itself.²⁵³ The English Parliament appointed “Commissioners appointed to look after the Trade of England”; they produced a report in November 1696 that points to there being at that time activities similar to modern time insider dealing. The Commissioners indicated that they had discovered a conduct that was carried out by subscribers of companies who transferred their shares to other ignorant buyers. The Commissioners reported that the result of such trading was to “prevent the end and design of companies”. This conduct was thought to have a damaging impact on the “Trade of England”. The activity was described as follows:

The pernicious Art of Stock-jobbing hath, of late, so wholly prevented the End and Design of Companies and Corporations, erected for the introducing, or carrying on, of Manufacturers, to the private Profit of the first Projectors, that the Privileges granted to them have, commonly, been made no other Use of, by the First Procurers and Subscribers, but to sell again, with advantage, to ignorant Men, drawn in by the Reputation, falsely raised, and artfully spread, concerning the thriving state of their Stock: Thus the first Undertakes, getting quite of the Company, by selling their shares for much more than they are really worth...the management of the Trade and Stock comes to fail into unskillful Hands.²⁵⁴

In 1697, the Parliament passed an Act “To Restrain the number and ill Practice of Brokers and Stockjobbers”. This should be understood in the light that stock-jobbing had a negative meaning at the time.²⁵⁵ Although the perception was to protect the design of the company, this conduct appears to have had characteristics similar to those of modern time insider dealing.

However, it took the UK around 300 years to introduce a straightforward prohibition of the act of insider dealing. Until 1980, there had been no statutory prohibition of insider dealing in the UK except for limited restrictions such as requiring the disclosure of dealing by directors. One reason for this attitude was the influential ruling in the leading case of *Percival v. Wright*²⁵⁶ that a director owes fiduciary duties only to the company as a whole and not to individual shareholders. While in the US, the regulation of insider dealing was

²⁵³ See HANNIGAN, BRENDA M. *Insider Dealing* (London 1st: Kluwer Law, 1988).

²⁵⁴ HOUSE OF COMMONS JOURNALS, 25 November 1696.

²⁵⁵ E. VICTOR MORGAN AND W.A. THOMAS *The Stock Exchange: its history and functions* (London: Elek Books, 1962). pp.21-24.

²⁵⁶ *Percival v. Wright*, [1902] 2 Ch. 421. This case was explained in more detail in Chapter 1, see footnote 75.

stimulated through the promulgation of the Securities Act 1933 and the Securities Exchange Act 1934, in the UK a statutory intervention had taken considerably longer.

In 1973, the Conservative government introduced a new Companies Bill. In this Bill, it was proposed that insider dealing was unfair and should be made a criminal offence. The Government White Paper stated that the objective was to ensure that insiders in possession of price-sensitive information should be restricted from dealing until the information were made available to the general investing public. However, the Bill was not passed due to the defeat of the Conservative government in 1974.²⁵⁷

The elected Labour Government initiated their own version of the reform of company law. The Labour Party Green Paper on the Reform of Company Law 1974 criticized the self-regulatory supervision of the City; it criticized the Department of Trade for being inadequately staffed and also criticized the decision to delegate to the Stock Exchange the power to formulate its own rules. The Labour White Paper of 1977 agreed that there were no legal sanctions aimed at discouraging insider dealing in the UK. Subsequently, the Companies Bill 1978 proposed that it should be a criminal offence for an insider to deal in securities while in possession of inside information. The Bill proposed adopting a wide definition of an insider as anyone who has inside information.²⁵⁸ However, this Bill also failed when the Labour Government was defeated in 1979.

Company Securities (Insider Dealing) Act 1985

Following several unsuccessful governmental initiatives, in 1980, Parliament amended the Companies Act to allow the introduction of rules prohibiting insider dealing. The Companies Act was revised in 1985 and the provisions regarding insider dealing became known as the Companies Securities (Insider Dealing) Act 1985.²⁵⁹ The Government

²⁵⁷ GIL BRAZIER *Insider Dealing: Law and Regulation* (London: Cavendish, 1996). pp.92-3.

²⁵⁸ *ibid.*, pp.93-4. Also explained in more detail in H. H. MARSHALL 'Insider Trading' (1978) 27 *The International and Comparative Law Quarterly* 250.

²⁵⁹ The rules were as follows:

Section 1(1) of the Company Securities (Insider Dealing) Act 1985:

“Subject to section 3, an individual who is, or at any time in the preceding 6 months has been, knowingly connected with a company shall not deal on a recognised stock exchange in securities of that company if he has information which-

(a) he holds by virtue of being connected with the company

(b) it would be reasonable to expect a person so connected, and in the position by virtue of which he is so connected, not to disclose except for the proper performance of the functions attaching to that position, and

(c) he knows is unpublished price sensitive information in relation to those securities.”

Section 9 of the Company Securities (Insider Dealing) Act 1985:

“For purposes of this Act an individual is connected with a company if, but only if-

delegated more powers to enforce the insider dealing provisions under the Financial Services Act 1986, sections 173-178.²⁶⁰ The provisions under both the Company Securities (Insider Dealing) Act 1985 and the Financial Services Act 1986 were repealed. Therefore, a detailed discussion of these provisions is not included in this thesis.

Briefly, it can be said that although the Company Securities (Insider Dealing) Act 1985 was a turning point in prohibiting insider dealing, there were deficiencies in several main areas. Under this Act, the scope of liability was rather narrow. The dependence on the criminal justice system to prosecute insider dealing, which requires a high burden of proof, resulted in a very low percentage of convictions. The self-regulatory regime at the time was also a reason for inefficiency. The powers delegated to the government by the Financial Services Act 1986 resulted only in slight progress being made. Thus, although insider dealing had been an offence since 1980, there were no successful prosecutions until the late 1980s.²⁶¹

Criminal Justice Act 1993 Part V

To remedy the narrow provisions of the Company Securities (Insider Dealing) Act 1985 and to implement the European Community Directive on Insider Dealing,²⁶² the UK had to introduce new legislation. Thus, the UK introduced the Criminal Justice Act 1993 Part V (CJA 1993).²⁶³ The new rules replaced the Company Securities (Insider Dealing) Act 1985.

(a) he is a director of that company or a related company, or

(b) he occupies a position as an officer (other than a director) or employee of that company or a related company or a position involving a professional or business relationship between himself (or his employer or a company of which he is a director) and the first company or a related company which in either case may reasonably be expected to give him access to information which, in relation to securities of either company, is unpublished price sensitive information and which it would be reasonable to expect a person in his position not to disclose except for the proper performance of his functions.”

²⁶⁰ KERN ALEXANDER *Insider Dealing and Market Abuse: The Financial Services and Markets Act 2000* (Cambridge: ESRC Centre for Business Research, University of Cambridge, Working Paper No. 222, 2001). p.6.

²⁶¹ KERN ALEXANDER, loc. cit.

²⁶² Council Directive 89/592 of 13 November 1989 coordinating regulations on insider dealing, OJL 334/30 (1989).

²⁶³ The most important provisions are in the following sections:

52- The offence.

(1) An individual who has information as an insider is guilty of insider dealing if, in the circumstances mentioned in subsection (3), he deals in securities that are price-affected securities in relation to the information.

(2) An individual who has information as an insider is also guilty of insider dealing if-

(a) he encourages another person to deal in securities that are (whether or not that other knows it) price-affected securities in relation to the information, knowing or having reasonable cause to believe that the dealing would take place in the circumstances mentioned in subsection (3); or

(b) he discloses the information, otherwise than in the proper performance of the functions of his employment, office or profession, to another person.

The CJA 1993 represented a departure from the notions of fiduciary duties and of requiring a connection between the insider and the source of inside information. Thus, it extended the scope of liability for insider dealing.

However, by introducing the CJA 1993, the UK government ignored the continuous complaints about criminal confrontation since it was introduced in 1980. It has been known that proving beyond reasonable doubt that someone had dealt on inside information is

(3) The circumstances referred to above are that the acquisition or disposal in question occurs on a regulated market, or that the person dealing relies on a professional intermediary or is himself acting as a professional intermediary.

(4) This section has effect subject to section 53 “Defences”.

56- “Inside information”, etc.

(1) For the purposes of this section and section 57, “inside information” means information which-

- (a) 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;
- (b) is specific or precise;
- (c) has not been made public; and
- (d) if it were made public would be likely to have a significant effect on the price of any securities.

(2) For the purposes of this Part, securities are “price-affected securities” in relation to inside information, and inside information is “price-sensitive information” in relation to securities, if and only if the information would, if made public, be likely to have a significant effect on the price of the securities.

(3) For the purposes of this section “price” includes value.

57- “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, inside information, and
- (b) he has it, and knows that he has it, from an inside source.

(2) For the purposes of subsection (1), 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).

58- Information “made public”.

(1) For the purposes of section 56, “made public”, in relation to information, shall be construed in accordance with the following provisions of this section; but those provisions are not exhaustive as to the meaning of that expression.

(2) Information is made public if-

- (a) it is published in accordance with the rules of a regulated market for the purpose of informing investors and their professional advisers;
- (b) it is contained in records which by virtue of any enactment are open to inspection by the public;
- (c) it can be readily acquired by those likely to deal in any securities-
 - (i) to which the information relates, or
 - (ii) of an issuer to which the information relates; or
- (d) it is derived from information which has been made public.

(3) Information may be treated as made public even though-

- (a) it can be acquired only by persons exercising diligence or expertise;
- (b) it is communicated to a section of the public and not to the public at large;
- (c) it can be acquired only by observation;
- (d) it is communicated only on payment of a fee; or
- (e) it is published only outside the United Kingdom.

almost impossible. There was a sound argument that depending only on criminal sanctions to regulate insider dealing was inappropriate. This argument was supported by the fact that there is a thin line between legitimate and illegitimate insider dealing activities. Criminalising insider dealing required introducing many safe-harbours and exemptions in order to avoid deterring legitimate market activities. Yet the strict definition, safe-harbours and exemptions made it almost impossible to prove an offence beyond reasonable doubt. The criminal sanctions were also criticized because they were directed only at individuals. A civil/administrative regime would require a lower burden of proof and would have the advantage of being applicable to issuers as well as individuals.²⁶⁴

There were many shortfalls in the criminal regime prohibiting insider dealing. It may be appropriate to indicate that the origin of such shortfalls was the inefficiency of the criminal justice system in prosecuting financial crime. The government rejected introducing a central regulatory body and the criminal justice system failed to meet the challenges inherent in prosecuting insider dealing under the CJA 1993.

The cornerstone of the difficulties in criminal prosecutions was the required standard of proof, which had to be beyond a reasonable doubt. The nature of the legislation, in other words, the legal requisites, compounded the difficulty of proving the offences beyond reasonable doubt. It is rationally thought that the requisites of the CJA 1993 also made it difficult to present an insider dealing case before a jury.²⁶⁵ In particular, the precedents reveal that the difficulties in insider dealing prosecutions were in proving that the insider possessed inside information, that he knew that it was inside information, and that a secondary insider knew that he had it from the relevant inside source. In *R v Holyoak, Hill and Morl*²⁶⁶ the three defendants were employees of an accountancy company. Their company was an advisor to the bidders in a takeover deal. The three defendants, due to their profession, had access to the inside information regarding the takeover bid. They dealt in the target's securities seven minutes before a takeover deal was disclosed. The next day they sold the securities making a profit of £13,000. The defendants pleaded that they thought the takeover was public information when they dealt. In spite of the circumstantial

²⁶⁴ ALISTAIR ALCOCK 'Insider Dealing - How Did We Get Here?' (1994) 15 *Company Lawyer* 67. pp.67-8 and 72.

²⁶⁵ MARGARET COLE, *Insider Dealing in the City*. Speech by Margaret Cole, Director of Enforcement, FSA London School of Economics, 17 March 2007.

²⁶⁶ *R v Holyoak, Hill and Morl*. Unreported case, but for explanation see MARGARET COLE, *Insider Dealing in the City*. Speech by Margaret Cole, Director of Enforcement, FSA London School of Economics, 17 March 2007.

evidence, the prosecution failed to establish the defendants' knowledge of the status of the information.

In the case of *Lord Advocate v Mackie*,²⁶⁷ Mr Mackie was an analyst who had a briefing meeting with the chairman of a company. He advised his clients on the basis of inside information. Mr Mackie was convicted of counselling or procuring others to deal contrary to the prohibition in the 1985 Act. However, because of the required standard of proof, the case collapsed on appeal. It could not be proved beyond reasonable doubt exactly what was said at the briefing meeting. There was said to be a conflict of evidence. Even the evidence of the chairman of the company, who said that he told Mr Mackie of a profits warning, was insufficient to sustain the evidence.

The CJA 1993 introduced difficult legal requisites in terms of the standard of proof and insiders' knowledge of the information and its source. These legal requisites were added to the CJA 1993 because it would have been inappropriate to impose criminal penalties on someone who did not realize that the information he possessed was inside information. One real problem with the CJA was that the wider scope of liability for insider dealing actions has required the introduction of more safe-harbours and exceptions. It was thought from the beginning that a few cases would be prosecuted and that there would be more acquittals than previously, because in practice it is difficult to prove the elements and requisites of the offence beyond all reasonable doubt.²⁶⁸

The introduction of insider dealing provisions in CJA 1993 was insufficient. To prevent insider dealing and maintain the integrity of financial markets, more reform had to be effected. The criminal law provisions constituted an inadequate method of addressing all the acts of market abuse. Rather, they were directed at the most serious cases of insider dealing. For a long time, the UK Government rejected recommendations to introduce civil law procedures. Such a position was based on the argument that insider dealing as a "public wrong" should be addressed by the criminal law.

In particular, there was a demand that a central enforcement agency should be given authority to apply both civil and criminal penalties. This argument was supported by the

²⁶⁷ *Lord Advocate v Mackie*, High Court of Justiciary, Edinburgh, March 1993. The case was decided under the Companies Securities (Insider Dealing) Act 1985, but it clearly supports the argument that it is difficult to prove beyond a reasonable doubt the elements of insider dealing offence.

²⁶⁸ ALISTAIR DARLING, the chief Labour Spokesman on House of Commons Standing Committee B, Fifth Sitting, 10 June 1993.

experience in the US, where the SEC has civil enforcement powers which are effectively utilized to prohibit insider dealing. There were demands for a more powerful regulator which could use civil fines to deter insider dealing.²⁶⁹

The efficiency of the CJA 1993 provisions has proved to be limited by the standard of proof required. Other self-regulations, which were introduced to address market abuse, did not appear to be a deterrent either. The number of cases brought to prosecution under CJA 1993 was low, and even so the percentage of convictions was unsatisfactory. A main cause of the low percentage of conviction was the standard of proof required in criminal cases. Unless the act and the state of mind were proved beyond reasonable doubt, the conviction would collapse.

The UK authorities had a poor conviction record. During the period between 1980, when insider dealing was first criminalized, and 1986, when the Financial Services Act 1986 was introduced, the Department of Trade and Industry prosecuted five cases. Four of them were successful. Following the introduction of the FSA 1986, it appears that there was no significant improvement.²⁷⁰ Following the introduction of the CJA 1993, the conviction record was still poor. The considerably limited number of convictions reached, as appears in Table (2), proved that the criminal sanctions and the regulatory system were insufficient to deter insider dealing.²⁷¹

Table 2 Number of prosecutions and convictions for insider dealing offences, England and Wales, 1986-1997.²⁷²

Number of defendants prosecuted at magistrates' courts and convicted at all courts for insider dealing offences, England and Wales, 1986-1997	Prosecutions	Convictions
Year		
1986	--	--
1987	1	1

²⁶⁹ MATTHEW WHITE 'The Implications For Securities Regulation Of New Insider Dealing Provisions In The Criminal Justice Act' (1995) 16 *Company Lawyer* 163. p.170.

²⁷⁰ JOHN M. NAYLOR 'The Use of Criminal Sanctions by UK and US Authorities For Insider Trading: How Can the Two Systems Learn From Each Other? Part 1' (1990) 11 *Company Lawyer* 53. p.57.

²⁷¹ It is difficult to make a valid comparison between the number of successful cases and the number of traded securities or transactions. In any case, it is apparent that the number of successful cases is very small. See above heading: Is the US system pre-eminent in terms of enforcement?

²⁷² HOME OFFICE (UK), *Home Office Court Proceedings Database*, (URL) <<http://www.homeoffice.gov.uk/about-us/freedom-of-information/released-information/foi-archive-crime/>>, accessed on 6/11/2007. The law applicable to the prosecutions of 'insider dealing' for the period 1986 to 1997 included provisions of Companies Securities (Insider Dealing) Act 1985 which came into force on 1 July 1985 and provisions of the Criminal Justice Act 1993 which came into force on 1 March 1994. The convictions in each year in the table may include those proceeded against in earlier years.

1988	--	--
1989	11	2
1990	3	2
1991	8	2
1992	--	2
1993	2	2
1994	2	2
1995	2	--
1996	1	--
1997	--	--

Financial Services and Markets Act 2000

In 1997 the UK government introduced an initiative in proposing civil prohibitions on market abuse and delegating the FSA extra powers to impose the civil sanctions and to prosecute criminal offences of insider dealing. The initiative was represented by the Financial Services and Markets Bill.²⁷³ The promulgated Financial Services and Markets Act (FSMA) 2000 was intended to introduce civil offences, so that the standard of proof required is the balance of probabilities, which is a lower standard of proof than that required in criminal prosecutions.²⁷⁴

FSMA 2000 introduced a ‘market abuse’ regime. The new provisions introduce civil penalties and enforcement procedures. FSMA 2000 also delegated authority to the Financial Services Authority (FSA) to address the offences of misuse of information and market manipulation.²⁷⁵

One of the shortcomings in CJA 1993 was identified as a poor record of conviction, due to the high level of proof required in criminal prosecutions. Another shortcoming was that the provisions do not cover all types of market abuse activities. Some of market abuse activities were covered by self-regulation. Thus, FSMA 2000 was introduced on the rationale that the new regime was to fill the “gap in the protections” left by the criminal provisions and self-regulatory rules.²⁷⁶

In order to maintain the integrity of financial markets it was essential that the behaviour of market abuse should be addressed. The insider dealing provisions under CJA 1993 do not

²⁷³ See generally ANNABEL SYKES ‘Market Abuse: A Civil Revolution’ (1999) 1 *Journal of International Financial Markets* 59. Also in GLENDA DAVIES AND CHARLES ABRAMS ‘The Financial Services and Markets Bill in Standing Committee: The Story So Far’ (1999) 1 *Journal of International Financial Markets* 276.

²⁷⁴ MICHAEL FILBY ‘Part VIII Financial Services and Markets Act: Filling Insider Dealing’s Regulatory Gaps’ (2003) 24 *Company Lawyer* 334. p.366.

²⁷⁵ FSMA 2000, s 118.

²⁷⁶ MICHAEL FILBY ‘Part VIII Financial Services and Markets Act: Filling Insider Dealing’s Regulatory Gaps’ (2003) 24 *Company Lawyer* 334. p.363.

address the impact of the offender's act upon the financial markets. FSMA 2000 introduced the market abuse regime, which gives priority to the impact of the offender's act upon the market. The objective of the new regime is to maintain the reputation of financial markets in the UK, thereby protecting the UK's position as a leading international financial centre by maintaining its reputation "as a fair and clean place to do business".²⁷⁷

The FSMA 2000 provisions complement the former offences of insider dealing under CJA 1993, rather than superseding them.²⁷⁸ The new regime delegated broader powers to the FSA to prohibit market abuse. This attempt appears to be filling the gap that had formerly existed. Another feature of complementation is that the FSA is empowered to prosecute insider dealing offences under CJA 1993 as well as offences of market abuse.²⁷⁹ Thus, when the FSA conducts an investigation, it has the following options:²⁸⁰ a) initiate criminal proceedings against the offenders; b) exercise the powers given to it by section 123 of FSMA 2000 and impose a penalty or make a public statement or take disciplinary action; c) take other regulatory action such as the issue of a restitution order asking the offenders to disgorge their illegal gains to those injured by their abusive behaviour; and d) apply to a court to seek an injunction, or a restitution order.

Market abuse and insider dealing were defined in the FSMA 2000 in Pt. VIII in the original section 118.²⁸¹ However, this section was superseded by new amendments which were

²⁷⁷ FSA, Consultation Paper No. 59, July 2000. *Market Abuse: A Draft Code of Market Conduct*. paragraph 1.1.

²⁷⁸ The question which arises is whether there is the possibility of a contradiction between the two acts. There is also a need to explain why more than one regime aimed to address the same problem, especially 'insider dealing'. A simple answer, which is inadequate in the prevailing relationship between the two acts, is that the new regime introduced new market abuse offences besides new insider dealing provisions. The latter are intended to cover a wider scope than the insider dealing provisions under CJA 1993. The difference between the two acts is still within the different nexus of "insider" and "inside information" between the two acts (this will be explained later in the thesis). See BARRY RIDER, KERN ALEXANDER AND LISA LINKLATER *Market Abuse and Insider Dealing* (London: Butterworths, 2002). p.47.

²⁷⁹ FSMA 2000, ss 397 and 402.

²⁸⁰ FSA HANDBOOK, *Enforcement Manual (ENF)*, ch.14.

²⁸¹ Section 118. –

(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)-

(a) which occurs in relation to qualifying investments traded on a market to which this section applies;

(b) which satisfies any one or more of the conditions set out in subsection (2); and

(c) which is likely to be regarded by a regular user of that market who is aware of the behaviour as a failure on the part of the person or persons concerned to observe the standard of behaviour reasonably expected of a person in his or their position in relation to the market.

(2) The conditions are that-

(a) the behaviour 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 or would be likely to

necessitated in order to implement the Market Abuse Directive²⁸² in the UK. The changes were reflected in a radical amendment of the offences of market abuse under the new section 118 of the FSMA 2000. The amendment was adopted under The Financial Services and Markets Act 2000 (Market Abuse) Regulations 2005.²⁸³

be regarded by him as relevant when deciding the terms on which transactions in investments of the kind in question should be effected;

b) the behaviour is likely to give a regular user of the market a false or misleading impression as to the supply of, or demand for, or as to the price or value of, investments of the kind in question;

(c) a regular user of the market would, or would be likely to, regard the behaviour as behaviour which would, or would be likely to, distort the market in investments of the kind in question.

²⁸² Directive 2003/6/EC of 28 January 2003 on insider dealing and market manipulation (market abuse) [2003] OJL 96/16.

²⁸³ The new section 118 of the FSMA 2000 determines behaviour amounting to insider dealing and market abuse as;

118 Market abuse

(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 subsection (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).

(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.

(3) The second is where an insider discloses inside information to another person, otherwise than in the proper course of the exercise of his employment, profession or duties.

(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.

(5) The fourth is where the behaviour consists of effecting transactions or orders to trade (otherwise than for legitimate reasons and in conformity with accepted market practices on the relevant market) which:-

(a) give, or are likely to give, a false or misleading impression as to the supply of, or demand for, or as to the price of, one or more qualifying investments; or

(b) secure the price of one or more such investments at an abnormal or artificial level.

(6) The fifth is where the behaviour consists of effecting transactions or orders to trade which employ fictitious devices or any other form of deception or contrivance.

(7) The sixth is where the behaviour consists of the dissemination of information by any means which gives, or is likely to give, a false or misleading impression as to a qualifying investment by a person who knew or could reasonably be expected to have known that the information was false or misleading.

(8) The seventh is where the behaviour (not falling within subsection (5), (6) or (7)) :-

(a) is likely to give a regular user of the market a false or misleading impression as to the supply of, demand for or price or value of, qualifying investments; or

(b) would be, or would be likely to be, regarded by a regular user of the market as behaviour that would distort, or would be likely to distort, the market in such an investment, and the behaviour is likely to be regarded by a regular user of the market as a failure on the part of the person concerned

The reform of FSMA 2000 appeared to be advantageous to the market abuse regime in the UK. An advanced comprehensive regime was aimed at by the reform. Nevertheless, the reform is confusing, since market participants have to comply not only with the provisions of offences described in Market Abuse Directive, but also with the complex illustrations found in the original section 118 of FSMA 2000.²⁸⁴ Such confusion is against the interests of market participants who showed strong objection. The result was the Treasury's decision to retain the 'misuse of information' and 'distortion' offences under section 118(4) and (8), but subject to the introduced 'sunset' clause under section 118(a) which means the offences will be abolished in July 2008.

Regarding the scope of the new regime, the FSMA 2000 market abuse and insider dealing provisions extended the former provisions in two main aspects:²⁸⁵

- a) It extended the scope to cover unauthorised persons as well as authorised persons. Therefore, the new insider dealing provisions differ from of CJA 1993. The new provisions have a wider scope, since they are applicable not only to authorised persons, but also to all those who participate in certain prescribed markets.²⁸⁶
- b) Another apparent extension of scope is that insider dealing provisions under CJA 1993 are applicable to corporate securities and derivatives on such securities only. While the market abuse and insider dealing provisions under FSMA 2000 are applicable to markets in commodity derivatives and financial futures.

It is obvious that the ambit of the FSMA 2000 insider dealing and market abuse provisions cover a wider range of actions than that of the CJA 1993. There is another limitation in the CJA 1993 provisions: they are directed to offences in connection with securities only. The CJA 1993 provisions do not cover insider dealing in the derivatives and commodities markets. Securities exchange markets are at the same level of importance as other derivatives and commodities markets. It is not clear why the UK government provided more protection for securities markets. Why only insider dealing in connection with

to observe the standard of behaviour reasonably expected of a person in his position in relation to the market.

(9) Subsections (4) and (8) and the definition of "regular user" in section 130A(3) cease to have effect on 30 June 2008 and subsection (1)(b) is then to be read as no longer referring to those subsections.

²⁸⁴ AVGOULEAS, EMILIOS *The Mechanics and Regulation of Market Abuse* (Oxford: Oxford University Press, 2005). p.312.

²⁸⁵ BARRY RIDER, KERN ALEXANDER AND LISA LINKLATER *Market Abuse and Insider Dealing* (London: Butterworths, 2002). p.48.

²⁸⁶ The prescribed markets are those operated by the seven UK recognised investment exchanges (RIEs). Prescribed markets are determined under the (Prescribed Markets and Qualifying Investments Order 2001).

securities should be criminalized is a question which the UK government has not clearly answered. It can be argued with reason on this account that there is no convincing reason for retaining the CJA 1993 provisions.²⁸⁷

The offences introduced by Market Abuse Directive are sufficiently broad to cover almost all abusive behaviour which the UK deemed it necessary to prohibit. The criminal law provisions attracted their share of criticism, as the offences require intent. This is difficult to prove and the complexity of financial crimes cannot be faced by a weak criminal justice system. A sound result would have been to implement Market Abuse Directive and abolish former insider dealing offences. CJA 1993 was adopted to implement the Insider Dealing Directive which is in turn is redundant, since Market Abuse Directive²⁸⁸ states that: “Given the changes in financial markets and in Community legislation since the adoption of Council Directive 89/592/EEC of 13 November 1989 coordinating regulations on insider dealing, that directive should now be replaced to ensure consistency with legislation against market manipulation. A new directive is also needed to avoid loopholes in Community legislation which could be used for wrongful conduct and which would undermine public confidence and therefore prejudice the smooth functioning of the markets”.²⁸⁹ The UK position is criticized because the criminal law provisions are still based on a redundant European Directive of 1989, while the market abuse regime is based on Market Abuse Directive.²⁹⁰ The UK government would have been much more unambiguous if it had abolished the CJA 1993 provisions and replaced them with criminal and civil sanctions for offences under section 118.²⁹¹

Evaluation of the current insider dealing regulation in the UK

The extent to which the UK government has been struggling to introduce a thorough regime of market abuse containing insider dealing offences is surprising. The resulting confusion may be explained by the fact that the UK government did not compromise by abolishing criminal sanctions under CJA 1993. Retaining the criminal sanctions is probably an indication that the UK government considers insider dealing as a public wrong and there

²⁸⁷ More explanation below under heading: The scope of financial instruments covered by the regulation of insider dealing.

²⁸⁸ Directive 2003/6/EC of 28 January 2003 on insider dealing and market manipulation (market abuse) [2003] OJL 96/16.

²⁸⁹ *ibid.*, Recital 13.

²⁹⁰ AVGOULEAS, EMILIOS *The Mechanics and Regulation of Market Abuse* (Oxford: Oxford University Press, 2005). p.338.

²⁹¹ *ibid.*, p.338.

should be criminal sanctions against individuals who engage in insider dealing. It is also true that the UK government in retaining criminal sanctions intended to dedicate them to serious offences where administrative penalties do not seem to be deterrent. This is obvious in the following case, which was recently decided.

In December 2004, Asif Nazir Butt was convicted of conspiracy to commit insider dealing in breach of section 52(1) of the Criminal Justice Act 1993. He was sentenced to five years imprisonment for this offence. A confiscation order was made to the sum of £348,325 and he was also ordered to pay £60,000 for the prosecution costs. Four co-accuseds were also convicted of the same offence.²⁹²

The facts of the case were that the applicant worked for the investment bank of Credit Suisse First Boston. He was in a particular position of trust. His responsibilities included the highly trusted task of ensuring the secrecy of dealings in the compliance department of the bank known as the Compliance Control Room. Because of his job, he was given privileged access to highly confidential inside information that was price sensitive relating to the status and performance of companies the bank was advising. Accordingly, as an experienced officer, he should have been, aware of the responsibilities arising from his job. It was a central requirement of his employment that he should not disclose or use the information he received in confidence in the course of his duty. However, Mr Asif Nazir engaged in using confidential inside information relating to certain companies that conducted business with his company. The applicant entered into spread bets on the basis of inside information before such information had been made public. The applicant acted in conspiracy with co-accuseds to implement a scheme where the actual transactions did not take place in the name of the main applicant. The applicant used the co-accuseds to trade for him through dealing accounts that they opened in their own names. They shared the profits between them and they were recorded by one of them on a computer. It is important to note that applicant was allocated nearly 80 per cent of the profits, a fact that contributed to his long-term imprisonment.²⁹³

The retention of parts of the original section 118 also resulted in the current law of insider dealing in the UK being fragmented and in it attracting criticism for opacity and

²⁹² *R v. Asif Nazir Butt* 2006 WL 421849 (CA (Crim Div)), [2006] 2 Cr. App. R. (S.) 44, [2006] EWCA Crim 137.

²⁹³ *ibid.*, at 296.

repetition.²⁹⁴ There was a trend to maintain the UK's position as a leading financial centre, which led to the introduction of FSMA 2000. The difficulty was compounded when new EC Directives were introduced that required changes to FSMA 2000. In this sense, the UK government preferred to make cosmetic changes to former Acts. This was a result of the government's insistence on its original definition of market abuse to a degree that it retained parts of it in the amended section 118. The Treasury and the FSA insisted on retaining the offence of 'misuse of information' under a 'sunset clause'.²⁹⁵ The retention of this offence is a clear example of the repetition of similar provisions. This trend proved confusing, since financial law is already a complicated area and there is no need to create further obstacles for market participants.

Misuse of information

In fact, the FSA benefited from the vagueness of the provisions and their low legal requisites in combating insider dealing. It is, therefore, not surprising that the FSA insisted on the retention of the provisions relating to 'misuse of information'. The offence of 'misuse of information' comprises behaviour based on information that which is not generally available to those using the market but which, if available to a regular user of the market, would or would be likely to be regarded by him as relevant when deciding the terms on which transactions in investments of the kind in question should be effected.²⁹⁶

The prohibition of such behaviour could be based on a similar rationale to that of prohibiting insider dealing, that is, the protection of market users and putting them on an equal footing. All market users are in need of certain information to decide their transactions. Thus, misuse of relevant information that is expected to be disclosed will affect confidence in the integrity of the market. Market users consider it unfair when certain market participants use information for their own benefit before it becomes generally available.²⁹⁷

The offence of 'misuse of information' was introduced in the original section 118 of FSMA 2000. The aim was to cover a wider range of actions beyond the criminal offences of insider dealing. It is apparent that this offence has a similar category to the CJA 1993 offences, but they are not identical. The FSA asserted that this category is not intended to

²⁹⁴ AVGOULEAS, EMILIOS *The Mechanics and Regulation of Market Abuse* (Oxford: Oxford University Press, 2005). p.338.

²⁹⁵ *ibid.*, p.337.

²⁹⁶ FSMA 2000, section 118(4).

²⁹⁷ BARRY RIDER, KERN ALEXANDER AND LISA LINKLATER *Market Abuse and Insider Dealing* (London: Butterworths, 2002). p.47.

be identical to the formerly existing CJA 1993 provisions.²⁹⁸ This offence has a wider scope, since there is no requirement of a nexus to the ‘insider’; in other words, not only ‘insiders’ are prohibited. Instead, information is misused if a regular user would, or would be likely to regard the information as relevant when making his decision.²⁹⁹ The information must relate to matters that a ‘regular user’ would reasonably expect to be disclosed to all the prescribed market participants. The difference of the type of relevant information to this offence is a key factor in indicating its different scope. However, it remains the case that this particular offence has a similar category to CJA 1993 offences. When section 118 was amended and new insider dealing provisions were introduced, the FSA insisted on retaining the offence of ‘misuse of information’ under a ‘sunset clause’. The ‘misuse of information’ provisions are a vital weapon in the FSA arsenal. The FSA depended on the provisions of misuse of information to bring a number of successful cases. As to the year 2007, the FSA brought eleven successful cases of misuse of information. This represents a better result when compared to the results of prosecuting similar acts under insider dealing criminal provisions. Under the latter provisions, in the period between 1987 and 1997 there were only 13 successful convictions.³⁰⁰ Following are some of the cases.

Middlemiss was the Company Secretary at Profile Media Group (PMG). During the week beginning 22 April 2002, he was aware of the material problems relating to a subsidiary of PMG. He was aware that PMG’s revenues were likely to be significantly below expectations. On Friday 26 April 2002, Mr Middlemiss sold PMG ordinary shares. Mr Middlemiss did not seek permission from PMG’s Chief Executive Officer. Following the announcement, the share price dropped significantly. By selling Profile Media Group shares when he did while in possession of information not generally available, Mr Middlemiss avoided a loss.³⁰¹ Mr Middlemiss was in possession of relevant negative information concerning PMG. Mr Middlemiss sold the shares at a time when he knew that PMG’s largest subsidiary was having difficulties in business performance and there was a

²⁹⁸ FSA, Consultation Paper No. 59, July 2000. *Market Abuse: A Draft Code of Market Conduct*. paragraph 6.18.

²⁹⁹ BARRY RIDER, KERN ALEXANDER AND LISA LINKLATER *Market Abuse and Insider Dealing* (London: Butterworths, 2002). p.75.

³⁰⁰ CARLOS CONCEICAO ‘The FSA’s Approach to Taking Action Against Market Abuse’ (2007) 28 *Company Lawyer* 43. p.44. Also see ANDREW HENDERSON ‘First Light: The Financial Services Authority’s Enforcement of the Market Abuse Regime’ (2005) 20 *Journal of International Banking Law and Regulation* 494.

³⁰¹ FINANCIAL SERVICES AUTHORITY, Final Notice, *Robert Middlemiss*, 10 February 2004. pp.2-5.

strong possibility that PMG would need to make a trading announcement. The FSA found that Mr Middlemiss's behaviour amounted to 'misuse of information' under the original Section 118 of the FSMA 2000.

Another important case related to GLG, which is based in London and is involved in hedge fund management. Mr Philip Jabre managed the GLG Market Neutral Fund. He was responsible for the investment management of designated funds and individual portfolios. He was empowered to make investment decisions and place orders regarding both the funds and portfolios. In mid-January 2003, the Japanese corporation Sumitomo Mitsui Financial Group Inc (SMFG) raised JPY 150 billion via a private placement of convertible preference shares with GSI who were pre-marketing the issue. On 7 February 2003, SMFG agreed with GSI to carry the role of lead manager/underwriter for a proposed public issue by SMFG of convertible preference shares. On February 17, the structure of the issue was announced on the Tokyo Stock Exchange. Mr Jabre was informed of the issue on February 11. The Chinese-walls were crossed and had given Mr Jabre advance confidential information on the issue and its intended structure. Between 12 and 14 February 2003, Mr Jabre, on behalf of the GLG Market Neutral Fund, short-sold ordinary shares in Sumitomo Mitsui Financial Group Inc (SMFG) to the value of \$16 million. His action was ahead of the announcement of the issue and was based on information that was not generally available to those using the market.³⁰²

³⁰² FINANCIAL SERVICES AUTHORITY, Final Notice, *Philippe Jabre*, 1 August 2006. The following were also important cases of misuse of information:

Financial Services Authority, Final Notice, *Michael Thomas Davies*, 28 July 2004.

Michael Davies was an assistant accountant at the Berkeley Morgan Group (BMG). As an accountant he had access to the chairman's statement containing important parts of the announcement and BMG's interim results. While in possession of the information, Mr Davies purchased shares in BMG the day before the announcement of the interim results. Following the announcement, he sold the shares making a profit. The FSA considered that Mr Davies' activity amounted to 'misuse of information' under the original Section 118 of the FSMA 2000.

Financial Services Authority, Final Notice, *Arif Mohammed*, 18 May 2005.

Mr Arif Mohammed was a former PricewaterhouseCoopers (PwC) audit manager. Delta plc was an audit client of PwC. Mr Arif Mohammed as a member of the audit team became aware of confidential information relating to Delta plc. The confidential information was that Delta intended to sell its electrical division. He was told that the information was confidential and not to be discussed or disclosed. While in possession of this confidential information, he purchased shares in Delta. Following the announcement, Mr Arif Mohammed sold his shares making a profit. The FSA and the judgment of the Financial Services and Market Tribunal in its decision dated 29 March 2005 confirmed that Mr Arif Mohammed breached the original Section 118 of FSMA 2000, since his behaviour amounted to 'misuse of information'.

See also:

The FSA was satisfied that Mr Jabre had engaged in market abuse in breach of the original section 118 of the FSMA 2000. The FSA considered that Mr Jabre committed market abuse in short-selling 4,771 ordinary shares in SMFG between 12 and 14 February 2003. The dealings had a total value of around \$16 million and were made over the three days following Mr Jabre's having been informed of the new issue by GSI. The FSA decided that his behaviour amounted to 'misuse of information', and imposed on him a financial penalty of £750,000. Under section 118(2)(a) of FSMA, 'misuse of information' is behaviour that is based on information that is not generally available to those using the market but which, if available to a regular user of the market, would or would be likely to be regarded by him as relevant when deciding the terms on which transactions in investments of the kind in question should be effected.³⁰³

All things considered, we would conclude that the UK law of insider dealing is fragmented, opaque and repetitive. This is because similar provisions, which are dedicated to insider dealing and market abuse, are repeated under the original CJA 1993, and the new Section (118) under the FSMA 2000. However, each of the mentioned laws is sufficiently clear if read separately. As we shall see in Chapter 5 in which the legal rules are analysed assuming that they are isolated from the wider system.

FINANCIAL SERVICES AUTHORITY, Final Notice, *Robin Mark Hutchings*, 13 December 2004.

FINANCIAL SERVICES AUTHORITY, Final Notice, *David Isaacs*, 28 February 2005.

FINANCIAL SERVICES AUTHORITY, Final Notice, *Peter Bracken*, 7 July 2004.

³⁰³ FINANCIAL SERVICES AUTHORITY, Final Notice, *Philippe Jabre*, 1 August 2006. pp.16-18.

Structure and regulation at the Dubai International Financial Centre (DIFC)

In the financial world, financial centres in the US, Europe and South East Asia have been recognized. In contrast, the vast region between Europe and South East Asia with its large population and economic potential has long been without a world-class financial centre. The area has its own financial needs and economic ambition, and Dubai, which is part of it, has a comprehensive plan for establishing itself as the regional hub on the map of international business. These facts facilitated the premise for establishing the Dubai International Financial Centre (DIFC).

The DIFC was created as a bold step in establishing Dubai as a business hub and gateway for capital and investment in the region. The DIFC is a wholesale financial services centre. As an “onshore” financial centre, it was initiated to provide new opportunities for leading financial institutions to establish business in the centre. The central principle of the DIFC, which it is hoped will make Dubai the regional centre for the financial industry, is specialization in institutional finance. The DIFC will add an essential industry which is expected to contribute to the economic growth of Dubai, the UAE and the region as a whole.³⁰⁴

The DIFC aims to take a vital role in the economic development of the region by realizing the needs of institutions and governments. It is planned that the economic role of the DIFC will be attained by several methods. To mention but a few: the introduction of world-class financial instruments to broaden the traditional financing method provided by banks; the provision of investment opportunities to attract back to the region the liquidity of wealthy governments and individuals; contributions to planned privatizations, which will support economic liberalization in the region; the provision of a first-class example for the development of the regional stock markets; the supporting of the expansion of companies in the private sector, and the introduction of Islamic financial products to meet a growing demand for them.³⁰⁵

³⁰⁴ PRICEWATERHOUSECOOPERS, *Doing Business in the Dubai International Financial Centre* (2006). (URL)<[http://www.pwc.com/extweb/pwcpublishings.nsf/docid/3877195827441B878525719A0053788C/\\$File/doing_business_difc_0406.pdf](http://www.pwc.com/extweb/pwcpublishings.nsf/docid/3877195827441B878525719A0053788C/$File/doing_business_difc_0406.pdf)>, accessed on 24/10/2007.p.8. Also in MICHAEL BLAIR AND DENNIS ALIGA ‘A New Framework for Collective Investment Funds in the Middle East’ (2006) 21 *Journal of International Banking Law and Regulation* 440.p.440.

³⁰⁵ *ibid.*, p.10.

The innovative vision of the DIFC takes into consideration the establishment of a world-class regulatory and transparency environment. The financial laws and regulations of the DIFC had to represent the “race to the top” trend, if it aimed to gain the confidence of both the international regulatory bodies and investments. The introduction of a legal body resulted in a financial centre in the Middle East with a regulatory framework benchmarked with the best practices of London, New York and Hong Kong. It is thought that: “there is no close legal precedent for what has been created here”³⁰⁶. This is because of the creation of an entirely new financial, commercial and corporate jurisdiction in Dubai which is, in turn, a city in the Federation of the UAE. The authorities in the UAE did not anticipate the development of local jurisdiction, but rather created a new one, which has extensive legislative, judicial and executive powers in the “free zone” area of the DIFC. Revealing the legal steps in the evolution of the DIFC is important to a comprehensive understanding of how it constitutes a separate jurisdiction. The conventional legal framework for civil and commercial activities in Dubai is a combination of Federal and Dubai laws. In order to establish the new jurisdiction in the DIFC, Federal and Dubai laws were introduced to exempt the DIFC from existing civil and commercial laws. The objective of the exemption was to provide a clean sheet on which a new legal framework could be drafted in accordance with best practices in the world.

The first legal step was an amendment to the UAE Constitution Article (121), in which the exclusive legislative jurisdiction of the Federation was extended to include the power to establish Financial Free Zones and determine their exemption from the laws of the Federation. This amendment was established for the Federation to introduce Federal Law No.8 of 2004, concerning the Financial Free Zones in the United Arab Emirates.³⁰⁷ This Federal law empowers each Emirate to establish its own Financial Free Zone. The most important initiative of the law was its exempting all Financial Free Zones from civil and commercial laws within the UAE. It is ascertained, though, that UAE Criminal Laws, Administrative Laws and Anti-Money Laundering Laws are applicable.³⁰⁸ This was followed by Federal Law No.35 of 2004, concerning the Establishment of the Dubai International Financial Centre³⁰⁹ which was dedicated to establishing the DIFC as a

³⁰⁶ MICHAEL BLAIR AND JAMIE ORCHARD, ‘Legal Issues arising in the new Dubai International Financial Centre’ (2005) 20 *Journal of International Banking Law and Regulation* 207. p.207.

³⁰⁷ Federal Law No.8 of 2004, concerning the Financial Free Zones in the United Arab Emirates.

³⁰⁸ *ibid*, Article (3).

³⁰⁹ Federal Law No.35 of 2004 Concerning the Establishment of the Dubai International Financial Center.

financial free zone in Dubai. This law also determines the geographical area and location of the DIFC in the Emirate of Dubai.

The Constitutional amendment and Federal laws provided the basis for new Dubai laws to be drawn on a clean sheet. Dubai enacted a whole body of laws to establish the DIFC, its bodies and their powers. A detailed review of the laws and the established bodies of the DIFC, with their specialties and powers, is beyond our objectives. However, it is important to comprehend the organizational structure of the DIFC, as follow.

Dubai Law No.9 of 2004³¹⁰ was dedicated to the induction and development of the DIFC. This law concedes the financial and administrative independence of the DIFC. The law also exempts the bodies and establishments of the DIFC and their employees from rules and regulations otherwise applicable in the Emirate of Dubai.³¹¹ In addition, this law sets up organizational bodies and their authorities in order to activate the DIFC. The most important bodies initiated by this law are the President of the DIFC, who is appointed by a Decree of the Ruler of Dubai,³¹² the DIFC Authority and the Dubai Financial Services Authority (DFSA) which is the regulatory body of the DIFC.

Structure of the DIFC

The President of the DIFC

While the full legislative power within the DIFC remains with the Ruler of Dubai, he appoints the President of the DIFC who, in turn, has all the executive authority. All the institutions within the DIFC are accountable to the President.³¹³ The president of the DIFC has extended powers under Dubai Law No.9 of 2004, Article 13 (2). The President of the DIFC is empowered to issue regulations, create any administrations, councils or entities deemed necessary to achieve the objectives of the DIFC, appoint members of the board of the DIFC Authority and the Dubai Financial Services Authority and create registries, including registries of real estate, security and property.

DIFC Authority

The DIFC Authority is set up by Dubai Law No.9 of 2004, in which its functions are also determined. The DIFC Authority is generally charged with administering and supervising the DIFC. Amongst its specialties are developing overall strategies and policies for the

³¹⁰ Dubai Law No.9 of 2004, concerning the Dubai International Financial Centre.

³¹¹ *ibid*, Article 13(2).

³¹² *ibid*, Article 3(2).

³¹³ MICHAEL BLAIR AND JAMIE ORCHARD, 'Legal Issues arising in the new Dubai International Financial Centre' (2005) 20 *Journal of International Banking Law and Regulation* 207. p.209.

DIFC and, in light of these policies, it also provides overall administrative services, for instance, assisting license applicants at various stages. The DIFC Authority is also charged with developing laws relating to non-financial services activities which are not the specialty of the DFSA. Such laws include Company Law, Employment Law and Contract Law. As the administrative body, the DIFC is also responsible for registering companies and securities in the DIFC.³¹⁴

Dubai Financial Services Authority (DFSA)

This body shall be specifically reviewed, since it is the most relevant to our subject. The DFSA is the regulatory body of the DIFC. The DFSA was established under Dubai Law No.9 of 2004 and mandated power as the regulator under the provisions of the Regulatory Law DIFC Law No.1 of 2004. Thus, as a body within the DIFC, the DFSA is exempted from Federal and Dubai laws including financial laws and regulations. It is also important to indicate that the DFSA is independent of the Securities and Commodities Authority (SCA) since the DFSA is charged with regulating financial services within the DIFC, while the SCA is charged with regulating local financial services. It is also apparent that the financial regulatory system in the DIFC is statutory based with a statutory independent body charged with regulation.

The DFSA is the statutory regulator charged with authorizing, licensing and registering institutions and individuals to carry on financial and ancillary services in or from the DIFC. In authorizing, licensing and registering institutions and individuals to operate in the DIFC, the DFSA examines their compatibility to maintain the standards required of them. The DFSA also has supervisory functions on market activities and performs other regulatory and enforcement functions. It monitors regulated participants' compliance with laws and regulations. To perform as a statutory regulator, the DFSA is empowered to make regulations and enforce them.³¹⁵

Since its establishment the DFSA has benefited from its powers to create a regulatory environment corresponding to the DIFC's principles of integrity, transparency and efficiency. It has introduced a regulatory framework benchmarked with the best practices of the world's leading financial jurisdictions. The regulations are also clearly drafted benefiting from the clean sheet left to regulators to fill in. In order to achieve its ambitious

³¹⁴ PRICEWATERHOUSECOOPERS, *Doing Business in the Dubai International Financial Centre* (2006). (URL)<[http://www.pwc.com/extweb/pwcpublishings.nsf/docid/3877195827441B878525719A0053788C/\\$file/doing_business_difc_0406.pdf](http://www.pwc.com/extweb/pwcpublishings.nsf/docid/3877195827441B878525719A0053788C/$file/doing_business_difc_0406.pdf)>, accessed on 24/10/2007.p.15.

³¹⁵ PRICEWATERHOUSECOOPERS loc.cit.

objectives the DFSA employed a team of regulators who made the most of years of experience in leading international regulatory bodies.³¹⁶

DIFC Judicial Authority

Dubai Law No.9 of 2004 provides for the formation of DIFC courts. These DIFC courts have exclusive jurisdiction over any action involving the DIFC or any of its bodies or establishments or involving DIFC based transactions and litigants.³¹⁷ DIFC Judicial Authority is responsible for administering civil and commercial laws constituting the jurisdiction of the DIFC, in order to provide an independent and flexible judiciary in the DIFC. To provide for the details of the judicial system Law No. 12 of 2004 was dedicated to the DIFC Judicial Authority and the DIFC Court System. This law recognizes the powers of the DIFC courts, which are to be practised in an independent manner.

Dubai International Financial Exchange Limited (DIFX)

The DIFX is a wholly-owned subsidiary of the DIFC Authority. An exchange works under clear regulations; this is closely related to the subject of this thesis. The DIFX aims to meet the region's need for a large and liquid securities market. In doing so, DIFX will provide a new option for international investors. The DIFX also aims to provide a recognized marketplace for issuers who wish to direct regional capital.

The DIFX plans to provide a wide range of financial instruments to attract investors as well as listing institutions to the exchange. These include, equities, bonds, funds, Islamic (Sharia-compliant) structured products, derivatives, index products and alternative risk products.

The DIFX envisioned that listings would be mainly derived from Initial Public Offerings (IPOs) by corporations already listed on other exchanges. The next stages are expected to bring in institutions wishing to dual list their shares on the DIFX, to benefit from the liquidity in the region.

The DIFX started where others had reached in marketplace technology, by providing state-of-the-art technology and a fully integrated electronic marketplace. The DIFX aims to provide market participants with an efficient and cost-effective technology infrastructure. It has contracted to recognized technology providers to supply an automated electronic trading system and clearing and settlement services.

³¹⁶ PRICEWATERHOUSECOOPERS op.cit., p.15.

³¹⁷ Dubai Law No.9 of 2004, Article (8).

The DIFX takes into consideration the importance of regulation in attracting investments to the market. It adopts the following regulatory principles: promoting international and regional investor confidence in the market, maintaining the quality and attractiveness of its market to issuers and investors and operating orderly markets. As indicated, the DIFX is regulated by the DFSA. In addition, the DIFX has its own regulations, constituted by its Listing Rules and Business Rules. The DIFX Market Authority is responsible for maintaining an informed and transparent market, whereas the DIFX Listing Authority is responsible for verifying applications for listing securities.

*Other bodies of the DIFC*³¹⁸

The DIFC Registrar of Companies (ROC) is another independent body. It operates under the Companies Law, specializing in incorporating and registering all types of companies in the DIFC.

DIFC Investments (Company) LLC (DIFC Investments) is also a wholly-owned subsidiary of the DIFC Authority. It has been launched under the objective of conducting activities for the DIFC which are non-public administration related.

Hawkamah Corporate Governance Institute (CGI) is the first of its kind in the region. Its establishment targeted assisting the countries and companies of the region to implement the principles of corporate governance.

The regulation of insider dealing in the Dubai International Financial Centre (DIFC)

In the DIFC jurisdiction insider dealing is prohibited mainly under Articles (42) to (45) of Markets Law, DIFC Law No.12 of 2004.³¹⁹ It is challenging to holistically explain the rules

³¹⁸ PRICEWATERHOUSECOOPERS, *Doing Business in the Dubai International Financial Centre* (2006). (URL)[http://www.pwc.com/extweb/pwcpublishations.nsf/docid/3877195827441B878525719A0053788C/\\$file/doing_business_difc_0406.pdf](http://www.pwc.com/extweb/pwcpublishations.nsf/docid/3877195827441B878525719A0053788C/$file/doing_business_difc_0406.pdf), accessed on 24/10/2007.p.17-19.

³¹⁹ 42. Insider dealing

(1) A Reporting Entity or person in a special relationship with a Reporting Entity shall not, in the DIFC or elsewhere, deal in Investments of or relating to the Reporting Entity if the person possesses material information that:

- (a) is not generally available in the market; and
- (b) has not been disclosed to the market in accordance with this Law or the Rules.

(2) In this Article:

“*Investments*” does not include:

- (a) options to acquire or dispose of;
 - (i) commodities of any kind; or
 - (ii) an option to acquire or dispose of an Investment of the kind specified by Article 42(2).

related to insider dealing under the DIFC Law. This is because of the facts that the rules included complex terms, there has not been any case brought under these rules which may serve as judicial interpretation and that there is a scarce academic reference in the field. However, there is a considerable work in comparative jurisdictions which can be approached whenever seemed necessary. Therefore, the rules will be compared to their equivalent in the US and the UK in following chapters. As this chapter aims at providing

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- (b) rights under a contract for the sale of a commodity under which delivery is to be made at a future date and at a price agreed on when the contract is made; or
 - (c) any right to or interest in anything which is specified by Article 42(2) (a) and (b).

43. Providing inside information

(1) A Reporting Entity or a person in a special relationship with a Reporting Entity shall not inform, other than in the necessary course of business, another person of material information that is not generally available in the market with respect to the Reporting Entity, before the material information has been disclosed to the market in accordance with this Law or the Rules.

(2) A Reporting Entity or a person in a special relationship shall not procure another person to deal in Investments if that Reporting Entity or person has knowledge of the material information that is not generally available in the market or the material information has not been disclosed to the market in accordance with this Law or the Rules.

(3) In this Article:

“*procure*” includes:

where a person induces or encourages another person by direct or indirect means.

44. Application of provisions

Articles 36 to 43 of this Part do not apply to conduct which occurs outside the jurisdiction unless the conduct affects the DIFC markets or users of the DIFC markets.

45. Definitions of material information and special relationship for this Part

(1) In this Part:

“*material information*” means:

(a) in relation to Investments, information that significantly affects, or would reasonably be expected to have a significant effect, on the market price or value of Investments; or

(b) in relation to the affairs of a Reporting Entity, information relating to a change in the business, operations or capital of the Reporting Entity that would reasonably be expected to have a significant effect on the market price or value of the Investments in or related to the Reporting Entity.

(2) In this Part:

“*a person in special relationship*” means:

(a) a person that is a director, officer, employee, affiliate, Associate or adviser of:

(i) the relevant Reporting Entity;

(ii) a person that is proposing to make a Takeover Offer under Part 7 for the shares of the Reporting Entity; or

(iii) a person that is proposing to be involved in a takeover with the Reporting Entity;

(b) a person that is engaging in or proposes to engage in any business or professional activity with or on behalf of the Reporting Entity or with or on behalf of a person described in Article 45(2) (a)(ii) or (iii);

(c) a person that is a director, officer or employee of the entity described in Article 45(2)(b);

(d) a person that learned of the material information with respect to the Reporting Entity while the person came within Article 45(2)(a), (b) or (c); or

(e) a person that learned of material information with respect to the Reporting Entity from any other person described in Article 45(2) (a), (b),(c) or (d) and knows or ought reasonably to have known that the other person is in such a relationship.

the background to these rules, it seems essential to evaluate the prospects of enforcing these rules in the future. This is through evaluating regulation in general at the DIFC.

Evaluation of the DIFC regulatory system

One of the principal methods through which the DIFC plans to achieve its economic role is the provision of a first-class example for the development and regulation of the regional stock markets. The centre's establishment was intended to be a landmark in developing regulation of regional financial markets through raising regulatory standards.³²⁰ The next section introduces a succinct evaluation of the DIFC laws and regulations for the purpose of this thesis.

The DIFC has adopted a complete body of laws beginning with Companies Law, Law of Obligations, Contract Law and Law of Obligations, along with Arbitration Law, Insolvency Law, General Partnership Law and Limited Liability Partnership Law. The jurisdiction is also advanced through introducing regulations that are benchmarked and continuously revised to implement international standards and best practices. There is a complete body of financial regulations. In addition, both the DIFC and the DFSA are actively introducing and amending regulations. In this respect, it is important that the DIFC and the DFSA put into place the core legislation and they both continuously conduct detailed self-assessment of the regulatory regime against the international best practice standards.³²¹

The DFSA has been successful in establishing and developing a first-class regulatory regime. This can be seen by the international recognition it received in a short time, especially from International Organization of Securities Commissions. The DFSA was accepted as an "IOSCO signatory"; this position is only permitted after rigorous assessment of the applicant's legislative and regulatory regime. An accurate assessment of the DFSA was conducted over five months by a specialist team from four countries and the assessment went to further consideration before the final approval of the IOSCO. It is worth noting that the DFSA is the only regulator in the Gulf Council Countries and the Arab World to be admitted as a signatory. IOSCO signatories represent the world's recognized

³²⁰ LINA SAIGOL AND WILLIAM Wallis 'Dubai Finance Centre Aims to Lift Standards in Middle East' *Financial Times*, July 07, 2006.

³²¹ DFSA, Consultation Paper No. 42, January 2007. *Proposed Enhancements to the DFSA Rulebook to Meet International Best Practice Standards*.

financial jurisdictions including the United Kingdom, France, Germany, the United States, Hong Kong, and Singapore.³²²

Recently the DIFC and its regulator the DFSA have received a highly positive assessment from the International Monetary Fund.³²³ The report included a detailed assessment of the DFSA's observance of the objectives and principles of securities regulation developed by the International Organisation of Securities Commissions (IOSCO). The report commented that:

The DFSA has established a very impressive set of laws, regulations and rules and policies and procedures for regulation... It has demonstrated a willingness and capacity to vigorously enforce its authority and carry out its regulatory mandate... The DFSA has shown a commitment to bring action against those in violation of the law and its rules...³²⁴

One issue that needs to be scrutinized is that the jurisdiction of the DIFC is based on English common law; while the conflict with the UAE jurisdiction is beyond the scope of this thesis, we need to know to what extent this affects the characteristics of the rules relating to insider dealing. This discussion may also provide an answer for the comparison between the UAE, UK and US insider dealing regulations.

The UAE Constitution provides that Islamic jurisprudence shall be a major source of legislation. The legal system of the UAE is based on the advantages of *Shari-ah* jurisprudence and the great Arab legal scholars of the tenth to thirteenth centuries.³²⁵ Nevertheless, the moderate *Shari-ah* jurisprudence does not contradict the country's promulgation of laws representing the public welfare. The UAE has developed a legal system which preserves the advantages of *Shari-ah* jurisprudence and simultaneously introduces laws which reflect the need of modern time. Thus, the codification of laws in the UAE has made use of emerging modern Arab nations, especially Egypt, which in turn base their laws on French jurisdiction and the Napoleonic Code. The introduced laws reflected

³²² DFSA MEDIA RELEASES *DFSA signatory to IOSCO memorandum of understanding: a first for the GCC* (2006) (URL)<http://www.complinet.com/dfsa/display/viewall_display.html?rbid=1547&element_id=7904>, accessed on 29/10/2007.

³²³ INTERNATIONAL MONETARY FUND, *United Arab Emirates- Dubai International Financial Centre: Financial Sector Assessment Program- Detailed Assessment of Observance of IOSCO Objectives and Principles of Securities Regulation* (Washington, D.C.: International Monetary Fund, 2007).

³²⁴ *ibid.*, p.7.

³²⁵ NICHOLAS B. ANGEL 'Regulation of Business under the Developing Legal System of the United Arab Emirates' (1986) 1 *Arab Law Quarterly* 119. p.124.

the political and business needs of the country to sustain its independence, oil wealth and economic policy. The legal system also utilized tribal and customary laws and reflected the UAE's legal contributions resulting from its special needs.³²⁶

The important consideration in legal codification in the UAE is its adoption of Franco-Latin jurisdiction through importing laws from the Egyptian legal system. This is in addition to preserving a mixture of legislative sources. Egypt at the time was an advanced legal system influencing newly formed systems in Arab countries.

In comparative studies, the compared laws can be from two or more different jurisdictions, as is the case in this thesis. Scrutinizing an issue from various perspectives constructs a positive comprehension of such an issue; this is the principle of comparative study. The proper objective of a comparative researcher is to conduct an analysis of different jurisdictions' responses to the same legal problem. If the study discovers that one of the jurisdictions provides a better solution for the legal problem, it reaches its objectives by making proposals for the improvement of the other system.

The law of the UAE is based on the characteristics of Franco-Latin law, while the UK and the US are countries of Common Law. When comparing the two jurisdictions in relation to a legal issue, the general characteristics of the two jurisdictions may be important. Thus, in general, it is perceived that a Common Law jurisdiction deals primarily with a legal problem through judicial precedents, since codification is not one of its characteristics. A Franco-Latin system is perceived as responding to a legal problem by legislation and codification, since judicial discretion and interpretation are limited. Generally, one criterion for differentiating between the two jurisdictions is "codified and non-codified".³²⁷ Another important criterion is "predictability", which, in turn, is closely related to the criterion of "codified and non-codified". In this relation jurisdictions differ in their preference for a detailed rule or wide discretion, imperative law or judicial empiricism, law or equity and statutory literalism and the spirit of the statute.³²⁸

We think that the generalizing concepts of the different characteristics of jurisdictions must be dealt with cautiously, especially in the area of this thesis, 'insider dealing'. This is for two reasons: first, the fact that a Common Law jurisdiction deals with a legal problem by preferring judicial precedent over detailed codification. This may be of little use when the

³²⁶ NICHOLAS B. ANGEL 'Regulation of Business under the Developing Legal System of the United Arab Emirates' (1986) 1 *Arab Law Quarterly* 119. p.125.

³²⁷ PHILIP R. WOOD, *Comparative Financial Law* (London: Sweet & Maxwell, 1995). pp. 24-5.

³²⁸ *ibid.*, p.27.

problem is dealt with by statutes. Insider dealing is dealt with by statutes, as Philip R. Wood points out:

When it comes to statutes, states have very different ideas on the degree of detail which is needed. A few examples will suffice... In the United States, a prohibition on conflicts of interest by trustees as bondholder representatives elaborated itself expansively into a prescriptive list full of busy detail, but Luxembourg, Japan and Britain merely outlaw “conflicts of interest” and leave it to reasoning and decided case law to fill this out. In the United States, the criminal offence of insider dealing was developed by case-law from a ten-line general anti-fraud section, whereas by contrast the European Union decided that the matter should properly be dealt with in Directive approximately 1000 per cent longer. Given this range of response on the same point, generalisations about national characteristics are unsafe.³²⁹

It is well known that currently in every branch of the common law there is considerable statutory intervention. This brings the essential question regarding the difference between ‘statute’ and ‘code’, which is still undecided clearly. That is to say while the code represents the “default” provision in civil law, is the role of “statute” in common law jurisdictions similar to that? The classical view in common law is that statute and case law are two distinct bodies of law and their application does not result in combination between them. In this respect statute and case law act as “oil and water”. In other words, statute is considered to be necessitated by a certain legislature policy, but the “default” principle is still that of common law. However, there is a sound argument that the “oil and water” approach should be reconsidered and even rejected. In the UK the role of statute should not be underestimated. There are increasing number of laws and statutes derived from the European Community. The majority of the EU members have civil law jurisdictions in which code represents the default provision. Therefore, it is reasonably argued that the difference between code and statute is not as fundamental as it appears.³³⁰ On this account it can be said that in the UK the regulation of insider dealing is reached by promulgating laws and statutes to implement EU directives. To respect the principles of implementation and harmonization, the effect of insider dealing statutes on developing common law has to be similar to the effect of code in the European civil law jurisdictions.³³¹

The second reason is that though it is true that the legal system of the UAE is based on the characteristics of Franco-Latin jurisdiction, its financial markets and regulation system are

³²⁹ PHILIP R. WOOD, *Comparative Financial Law* (London: Sweet & Maxwell, 1995). p.28.

³³⁰ J. BEATSON ‘The Role of Statute in the Development of Common Law Doctrine’ (2001) 117 *Law Quarterly Review* 246.

³³¹ It is still true that the role of statute in the US is not similar to that in the UK. Case law has been determining in interpreting the statutory rules related to insider dealing regulation.

based on the UK experience. The latter is particularly supported in the laws of the Dubai International Financial Center (DIFC) which are based on best practices in London, New York and Australia. In more than one law it is stated that failing to find a provision in DIFC enacted laws and any other agreed jurisdiction the laws of England and Wales are applicable.

The legal jurisdiction of the centre is based on English Common Law while the jurisdiction of law in the UAE is a civil law jurisdiction based on Egyptian and French law with some aspects of Shari'a law. In the interviews, members of the DFSA were asked whether this causes any difficulties. It could be tolerable for pragmatic business objectives to adopt a common law jurisdiction in the limited free zone area of the DIFC. As one interviewee said:

Capital markets flourished in circumstances where there is good law and consistency in the application of the law. There has not been in the UAE generally and in Gulf Council countries a well-understood international law that international clients could comply with. The jurisdictions vary from Gulf country to Gulf country and within the UAE generally. In order to attract capital back into these markets there needs to be a system of law that is easily understood and consistent with other systems in other jurisdictions around the world and can easily be applied...³³²

The issue of the constitutional amendment was raised, which allowed exempting free zones from the civil and commercial laws of the federation. The jurisdiction of the DIFC functions within the boundaries of its limited geographical area. As an interviewee indicated:

...because we operate as a free zone, so we operate within the boundaries of our zone. We are just a centre of excellence. We are aligned with other international financial centres. If you look at them, you find that they based on common law, e.g., New York, London, Singapore and Hong Kong, which are the four major financial centres in the world. Our jurisdiction is based on common law, which means that investors that already trading at that kind of market are ready to meet this standard, the legal regime and the rules and regulations that we also impose in our centre. For an investor it is easy to come and invest here. The same is true for big financial institutions that will be trading in London and New York. They kind of know the regime. That is why we adopted the common law system in the centre.³³³

³³² ANONYMOUS 2, Dubai Financial Services Authority, *Interview Transcript*. See Appendix 6, Interviews (5), (6) and (7).

³³³ ANONYMOUS 1, Dubai Financial Services Authority, *Interview Transcript*. See Appendix 6, Interviews (5), (6) and (7).

In fact, a comparison between the general characteristics of the jurisdiction could be misleading for the purpose of this study. To be more specific, the provisions of Company Law, Law of Obligations, Contract Law and the Law of Obligations in the DIFC could be different from their equivalent in the UAE jurisdiction. However, financial market regulation and the rules aimed at regulating insider dealing are in most jurisdictions very similar. As an expert interviewee thought:

Many of the laws that apply in most sophisticated capital markets have many similarities. For example, your securities law and collective investment law are not dissimilar. Your corporate governance requirements, for example, are not dissimilar. They are common from jurisdiction to jurisdiction. There might be some discrete differences, but in the main, most of the laws are very similar. Thus, firms and individuals who are actually in the market are mostly comfortable with this sort of legislation.³³⁴

Another important point is the nature of the rules directed to regulate insider dealing. It is right that such rules have the characteristics of criminal provisions and sometimes of civil provisions. However, the current trend is to delegate the regulator the power to enforce these rules. This means that the rules aimed at regulating insider dealing have the characteristic of administrative provisions. In fact, where the supervisory administrative regimes have similar characteristics, the resulted administrative rules will be similar, even though the larger jurisdictions are different. This view is supported by an expert whose opinion was as follows.

In fact, I think that when it comes to primary legislation, it does not matter much. When there are differences, for instance, if you compare between the regulation of insider dealing and enforcement in UK, US and Germany. I think you find a lot of similarity. In fact, you might find indeed different approaches in how to deal with an actual case. You might find differences in secondary legislation. I think the differences are marginal. I think it comes in fact to the effectiveness of the supervisory regime. You rarely look at the court to report a problem. If there is a problem, it is ensuring the prevention of insider dealing or the spread of inside information. How do you do that and who is closest to the source of information? That is naturally, I would argue, the financial services regulator who imposes certain restrictions...³³⁵

³³⁴ ANONYMOUS 2, Dubai Financial Services Authority, *Interview Transcript*. See Appendix 6, Interviews (5), (6) and (7).

³³⁵ ANONYMOUS 2, Dubai Financial Services Authority, *Interview Transcript*. See Appendix 6, Interviews (5), (6) and (7).

Therefore, it can be argued that the rules directed to insider dealing from common law jurisdictions to civil law jurisdictions have many similarities. This will be discussed in more depth when comparing the rules directed to insider dealing in the UAE, the US, the UK and the DIFC.

It is also important to investigate to what extent the DIFC laws and regulations have been tested. On the whole, it is still thought that the laws and regulations of the DIFC have not been truly tested. The International Monetary Fund report indicated that:

Because the DIFC and DFSA were established very recently and because activity within the DIFC is still new and somewhat limited, it was difficult to assess in-depth the effect of the new regulatory structure in practice.³³⁶

As Habib Almula, former MP (Member of the Federal National Council) and former Chairman of the Dubai Financial Services Authority said:

The particular problem is that there is no actual activity in the centre. More precisely, there is a limited volume of trading and it is incomparable to the local markets in the UAE. Thus, it can be said that there is activity regulated by no law (*he means local markets*) and there is law regulating no activity (*he means DIFC*). It is also right that the laws and regulations of the DIFC have not been examined except to a certain level.³³⁷

Indeed, in certain principal areas the law has been adequately tested. In other areas, such as the regulation of insider dealing, obviously the law has not been tested. That is due to the limited volume of trading especially in the secondary market. We introduce some reasons for the limited business in the DIFC and some instances in which the law was tested.

Since it opened in September 2004, the DIFC, applying the related regulations, licensed and authorized leading financial institutions to establish business in the centre. In this respect, it can be said that the licensing and authorization provisions in the Company Law and its underlying regulations, for example, have been tested.

The Dubai International Financial Exchange (DIFX) has succeeded in attracting almost 50% (by value) of all *sukuk* (Islamic bonds) listed on exchanges worldwide. The listing of

³³⁶ INTERNATIONAL MONETARY FUND, United Arab Emirates- Dubai International Financial Centre: Financial Sector Assessment Program- Detailed Assessment of Observance of IOSCO Objectives and Principles of Securities Regulation (Washington, D.C.: International Monetary Fund, 2007). p.7.

³³⁷ HABIB ALMULLA, Former MP (Member of the Federal National Council) and Former Chairman of the Dubai Financial Services Authority, *Interview Transcript*. See Appendix 6, Interview (4).

sukuk revealed the strength of the DFSA regime and the regulation related to collective investment funds and Islamic financial instruments.³³⁸

In another important area, the DIFC insolvency provisions were tested in the recent case of Forsyth Partners Global Distributors and Forsyth Partners (Middle East). The DIFC Court of the First Instance has announced the first insolvency proceedings in the DIFC and liquidators have been appointed.³³⁹

However, in general, there are considerations in regards to testing the laws and regulations of the DIFC. One probable reason for that is that in certain areas the business in the DIFC is underscoring. This is especially true in relation to attracting Initial Public Offerings and attracting listings in the DIFX. This is the reason behind the limited volume of trading in both the primary and secondary markets. One reason for this is the legal separation between the DIFC and the rest of the UAE. The legal separation and the underlying restrictions on business has been an area that has showed deficits that have hampered the business. There are some limits on activities created by the operation of Art.4 of the Financial Free Zones Law. The first restriction introduced by Art.4 has had the most hampering effect. It states, “Importantly, these entities shall not deal in the UAE Dirham and shall not take deposits from the UAE markets”. It is because of this restriction that the DIFC laws prohibit those who offer banking services from dealing in UAE Dirham.³⁴⁰ This restriction is compounded by the fact that the DIFC is a wholesale financial centre, which required another restriction on investment business, banking business and trust services to ensure that they do not conduct their business with or for a retail customer.³⁴¹

The DIFC is not only a separate jurisdiction to the rest of the UAE, but it is also separated from the UAE currency and financial policy (the currency of the DIFC is the US Dollar). The DIFC authorized firms are not allowed to conduct business in the local currency, they are not allowed to sell to retail investors and they are not allowed to take deposits from the local market. This restricts the money flow into the DIFC from the local economy of the UAE. Because of the restrictions on business rules, DIFC authorized firms, at least theoretically, cannot even offer investment products to investors in Dubai, though, in

³³⁸ HENDERSON, ANDREW ‘Testing the Water’ (2007) 26 *International Financial Law Review* 16.

³³⁹ RACHEL EVANS ‘DIFC Faces Insolvency Test’ *International Financial Law Review, News Analysis*. October 11, 2007.

³⁴⁰ MICHAEL BLAIR AND JAMIE ORCHARD, ‘Legal Issues arising in the new Dubai International Financial Centre’ (2005) 20 *Journal of International Banking Law and Regulation* 207. p.208.

³⁴¹ This restriction is stated in The DFSA Rulebook, Conduct of Business Module, part 1- restrictions on business, 3 investment business and banking business. Explained by MARC HAMBACH, DFSA, Associate Director, Supervision and Head of AML *Complinet Seminar ‘Conduct of Business’*, Doha, 21 June 2007.

reality, it is difficult to enforce these restrictions. Some speak of evading the rules by informal meetings with small groups. This is a predictable result, since a large percentage of the liquidity in the region's financial markets is from private individual wealth.³⁴²

According to the restriction on business rules in the DIFC, investment banks are under strict restrictions when selling securities in the UAE. While according the UAE law only a licensed bank or financial intermediate can promote and sell securities after obtaining a prior approval of the central bank, in practice as long as the offeror is not targeting unsophisticated retail customers then the UAE Central Bank does not strictly pursue the issuers' compliance with the restrictions. That is probably because the Central Bank pays more attention to protecting inexperienced retail investors than to protecting experienced wholesale investors.³⁴³

The separate legal jurisdiction and the restrictions on business rules proved to be hampering the business of the DIFC. This has been the case in initial public offerings, which were heavily reliant on retail investors. Selling securities to such investors directly or indirectly could have been against the restriction rules. Therefore, the regulators from both sides entered negotiations to reach a compromise. The solution was to allow intermediating brokers locally registered in the UAE to sell the initial public offering from the DIFC.³⁴⁴

The DIFC handicapped itself by choosing the difficult option of a separate jurisdiction and the restrictions from the rest of the economy of the UAE. This is thought to be an obstacle to firms wishing to do business in the DIFC; it also affects the growth of the volume of trading in the primary as well as the secondary market. One reason for these restrictions is the structure of the UAE, with different legislation at the federal level (UAE) and the local level (Dubai). The separate jurisdiction and restrictions on business rules are, in fact, compromises reached between Dubai, and the federal law and federal regulators. As an interviewee pointed out:

Dubai is a place that is very visible on the international scene. Dubai is so much out there in the global market. It is investing outwards and trying to attract capital; it is trying to improve its laws and regulations. The problem is that this is a federal system. Not everything can be done by Dubai alone; it has to be done at federal level. So, the banking system is very much behind the international banking system.

³⁴² See CROMPTON, SIMON 'Built on Shifting Sands' (2007) 26 *International Financial Law Review* 54.

³⁴³ CROMPTON, SIMON loc. cit.

³⁴⁴ CROMPTON, SIMON loc. cit.

It is still underdeveloped, even though it is improving slowly, but there is a long way to go before it matches one of the international banking systems.³⁴⁵

One of the main reasons why Dubai opted to establish a separate jurisdiction is the failure of attempts to reform laws and regulations at federal level. Attempts to introduce amendments to federal law may take several years and may collapse due to legislative bureaucracy. It was appropriate to benefit from the experience of other jurisdictions. The best solution would have been to move the whole jurisdiction closer to recognised jurisdictions, in a way similar to what was planned by Qatar. However, it was impossible to exempt Dubai from the federal legislation. The alternative bold idea was to establish the DIFC with a completely separate jurisdiction. As Habib Almula accurately pointed out, “Part of the solution is better than no solution”.³⁴⁶

As a consequence of this decision, another area that shows shortcomings in practice is the relationship between the DFSA, as the regulator of the DIFC, and the Ministry of Economy and Commerce, the Central Bank and the SCA, as the regulators of financial services in the UAE.³⁴⁷ The authorities and responsibilities of the three federal regulators in practice, to all intents and purposes, are in contradiction of the law. This is impeding the progress of finance and financial markets in the UAE. Yet the most complicated area is the relationship between the DFSA and the federal regulators. In practice, cooperation is weak and the only memorandum of understanding on information sharing was reached in October 2005 between SCA and the DFSA. Otherwise, the relationship between the DFSA and the federal regulators has not improved much. This has been evident in the difficult work between the DFSA and the Ministry of Economy and Commerce, as well as the significant discrepancy between the DFSA and the Central Bank. The approaches are just very different. The DFSA endeavours to raise the level of financial services regulation to international standards. On the other hand, the federal regulators are handicapped by the mindset against reform in developing countries.³⁴⁸

There have always been voices demanding a single sophisticated stock exchange in the UAE instead of a number of small exchanges. Currently, there are the Dubai International Financial Exchange, Dubai Mercantile Exchange, Dubai Financial Market, Abu Dhabi

³⁴⁵ ANONYMOUS 1, Dubai Financial Services Authority, *Interview Transcript*. See Appendix 6, Interviews (5), (6) and (7).

³⁴⁶ HABIB ALMULLA, Former MP (Member of the Federal National Council) and Former Chairman of the Dubai Financial Services Authority, *Interview Transcript*. See Appendix 6, Interview (4).

³⁴⁷ See above heading: The law of securities markets in the UAE.

³⁴⁸ CROMPTON, SIMON ‘Built on Shifting Sands’ (2007) 26 *International Financial Law Review* 54.

Securities Market and the Dubai Multi Commodities Centre. It was thought a merger between the Abu Dhabi and Dubai markets would be beneficial for the economy. However, the local governments of Abu Dhabi and Dubai own the majority of the two markets, and therefore, all suggestions regarding a merger have been brought to an end by political bureaucracy. A more feasible suggestion would be for a merger between Dubai International Financial Exchange and Dubai Financial Market. The DFM is a much more active exchange than is the DIFX and a merger would provide the best of both. In June 2006, it was suggested that DIFX was planning to merge with the DFM. However, this was considered to be impossible given the different levels of regulation at the exchanges.³⁴⁹ The suggestion of a merger has been revived following the recent incorporation of Dubai Bourse Holding, which is a DIFC incorporated holding company that holds the government's shares in the DFM and the DIFX. The issue of a merger surfaced again, but the difficult area is again the different levels of regulation. As an interviewee from the DFSA said:

Now, the interesting aspect of that is should there subsequently be a merger of these two markets. If that were the case, how would those entities be brought together? Where will the entity sit and where will the market be? Who would regulate the market how would insider trading activities on that market be regulated. What would be a good law and what would be a perceived law? How would we regulate a conduct by an individual outside the jurisdiction of the DIFC?³⁵⁰

Another point that should be emphasized is the wholesale nature of the DIFC. Thus, its laws and regulations should be interpreted taking into consideration that they are generally directed to wholesale sophisticated and institutional customers. Considering it a wholesale jurisdiction, the DIFC clearly states that the individual will not be afforded the retail customer protections and compensation rights that may generally be available to them in other jurisdictions.³⁵¹

The fact that the DIFC is a wholesale centre could also result in regulations being principle-based and less descriptive, since the targeted sophisticated investors, unlike the retail

³⁴⁹ CROMPTON, SIMON op. cit.

³⁵⁰ ANONYMOUS 2, Dubai Financial Services Authority, *Interview Transcript*. See Appendix 6, Interviews (5), (6) and (7).

³⁵¹ The DFSA Rulebook, Conduct of Business Module, part 1- restrictions on business, 3 investment business and banking business. Guidance 1.

investors, are expected to have the necessary knowledge or at least be capable of hiring it in order to comply with the regulations. As an interviewee from the DFSA pointed out:

It is also because we are a wholesale centre; we do not require such equal law (*descriptive law*), because we do not have to protect retail investors. Things may change in the future when we decide to allow retail investors; we will have to provide for a number of protections and disclosures in relation to these individuals, which is why it has been easier for us to have principle based regulation.³⁵²

Therefore, the notion that comes to mind is that the DIFC provides less protection for retail investors and its laws and regulations are less descriptive. This is thought to be reflected in the rules aimed at regulating insider dealing. However, such a notion could be misleading. In fact, when discussing the rules directed at insider dealing and timely disclosure, it can be argued with reason that the DIFC regulations are considerably clearer and more descriptive than are the regulations of the SCA. In addition, although the SCA regulations target retail investors, they do not seem to provide adequate protection for them and they are opaque even to legal experts.

After the overview of the law and regulation of the DIFC and a background to its establishment and business, the rules directed at regulating insider dealing can be better comprehended.

³⁵² ANONYMOUS 1, Dubai Financial Services Authority, *Interview Transcript*. See Appendix 6, Interviews (5), (6) and (7).

A comparative perspective of the systems of the US, the UK and the DIFC in regulating insider dealing

Regulatory system

The succinct discussion of the jurisdictions included a background to the regulatory system in the US, the UK and the DIFC. A review of the regulatory systems in the three jurisdictions is significant to this comparative study. In view of the fact that each jurisdiction has, over a long time, built up a regulatory system that is appropriate to its financial policy, a detailed discussion of these systems was not included. The discussion aimed at investigating the main characteristics of each system, in order to offer a background for the roles of the regulators in insider dealing regulation.

In principle, there are two major forms of regulatory system. The first major form is ‘self-regulation’, the principle under which market players independently adopt rules to be followed, and monitor the compliance with such rules. It is apparent that this form may be adopted only following years of market players’ expertise, and over cumulative reactions to market issues. The argument in favour of self-regulation is based on the expertise and knowledge of market players who are thought to be better at regulation than are governments. SROs are compelled to introduce the necessary regulations for economic reasons. It is in the interest of the SROs to maintain the confidence of investors and market participants through regulation. This discussion revealed that self-regulation is still the dominant system in the US. Nevertheless, the tasks of supervising the mandatory disclosure of information and enforcing the antifraud provisions (which are the basis for insider dealing regulation) are the responsibilities of the SEC. It should be clear that the self-regulatory system in the US is a result of the long experience the US has had in this field. On this basis, it can be argued that a self-regulatory system is inappropriate for an inexperienced country like the UAE, where the markets were established as recently as the year 2000. In fact, the UK abandoned self-regulation, which had long underpinned the financial industry. There has been evidence of deficiencies in SROs in the UK.³⁵³

The second form of regulatory system is ‘statutory regulation’, in which a government directly engages in regulation by introducing binding laws and statutes for markets. A statutory regulating authority may be more independent and free of market competition.

³⁵³ See above heading: The regulation of financial markets in the UK.

Such a body is thought to be more efficient in writing soft law and monitoring compliance. In this form, the government ensures compliance with the regulation by delegating the necessary powers to a governmental authority. Further details of the system, such as statutes, the formation of a competent authority and the delegation of powers to that authority, are to be tailored to the needs of the country.

In the UK, the FSA was established as a statutory regulatory body and extensive regulatory powers were transferred to it from SROs. In the DIFC, the DFSA as a regulator is close to being a facsimile of the FSA. It is apparent that the two regulators have clear responsibilities that are objectively stated. One main reason for establishing such a statutory regulatory body has been the objective of combating financial crime, including the investigation and prosecution of insider dealing. The SEC also as a regulator has always been admired for its efficiency in investigating and prosecuting insider dealing. Given this line of reasoning, it is prudent to say that any reform of the regulation of insider dealing has to consider the efficiency of the regulator in investigating and prosecuting financial crime. In addition, in countries like the UAE where there is more than one regulator, the responsibilities and objectives of the regulators should be clearly defined, avoiding any overlap.

Another important point is the delegation of authority to the regulator. The regulator has to be an independent body with sufficient authority. An efficient regulator is one to which adequate authority has been delegated in order to enable it to investigate and prosecute insider dealing. Moreover, the recent trend, as represented by the reforms in the UK, is to delegate to the regulator the power to enforce civil/administrative fines to deter insider dealing. It is not expected that insider dealing would be deterred where the regulator is not sufficiently empowered to combat financial crime. In fact, the empowerment of the regulator to make regulations and enforce them serves another objective, specifically, the transfer of the extra burden of responsibility from the legislative and judiciary systems to the financial regulator.

The empowerment of the regulator has to go hand-in-hand with clearly determining the regulatory objectives. The previous discussion has shown how the objectives of the SEC, FSA and DFSA are clearly determined, emphasised that combating fraud and financial crime is one of the main objectives. Therefore, any reform has to consider empowering the regulator and ensuring its objectives are clearly determined. Administrative empowerment

is as essential as legal empowerment. An efficient regulator should be able to dedicate sufficient expertise, personnel and resources.

Clarity of regulations

The discussion of insider dealing regulation in the US revealed the need for clarity of regulations. In the US, the administrative and judicial precedents have generated controversial interpretations of the antifraud provisions. The currently established theory of 'misappropriation' appears to be an extraneous reading of the provisions. However, it should be understood that insider dealing regulation in the US has been formed according to the circumstances of the country. The interpretation of the antifraud provisions has been a matter of dispute between the SEC and courts at different levels. Introducing a clear statutory definition at federal level has been difficult in the US, because it is a large country with different levels of legislative authority. It is, therefore, not surprising that the US approach has not been embraced by other jurisdictions. It should be noted that although the US approach has not been ideal, the precedents in the US have influenced the regulations in other jurisdictions.

In the UK, although the act of insider dealing has been clearly defined, the recent amendments created a fragmented and repeated area of law. This situation is also formed by the special circumstances in the jurisdiction. The authorities in the UK were under pressure to implement the EU directives. Having the provisions related to insider dealing scattered between the CJA 1993 and FSMA 2000 is confusing at least to the business world.

The act of insider dealing while in possession of inside information should be accurately defined if it is to be criminalized, because it is unfair to punish someone under an obscure law. The unambiguous definition of insider dealing serves another end, that is to say, the conventionally legitimate practices in the financial industry, for instance, insider dealing with no knowledge of the inside information, dealing on the basis of information from research that is not available to all the public, disclosure of information in the normal course of business and so on.

Clarity of financial regulation should not be compromised, because it is dedicated to business. In emerging markets, there is probably more demand for clarity of regulation, since there are insufficient precedents to serve as proper guidance. Accordingly, the

regulations at the DIFC and DFSA have been promulgated with consideration given to the importance of clarity and details.

Any pertinent reform of the regulation in the UAE has to take into account the clarity of regulation. Detailed definitions and sufficient guidance are essential to provide certainty for the financial industry. The recent amendments in the UK also prove that any cosmetic changes have to be made accurately in order to avoid confusion.

Criminal/civil sanctions

A comparison between the approaches of the US and the UK reveals the practicality of combining more than one kind of sanction. The outline of the UK approach indicated how the system for a long time depended on criminal sanctions. This was a main reason for the limited number of successful prosecutions. Introducing a civil/administrative regime in the FSMA 2000 was a response to the evidently limited successful criminal prosecutions that brought into question its impact on deterring insider dealing. On the other hand, in the US approach, administrative powers have made the difference in deterring insider dealing; such powers included the authority to impose a civil penalty and to order the disgorgement of profits.

Civil/administrative fines are advantageous because of the lower burden of proof than for a criminal prosecution. In addition, an administrative regime can also be imposed on legal persons, as will be discussed in following chapters. Administrative sanctions are not confined to fines; there can be other sanctions such as invalidating licenses, disqualifying an individual, disgorgement of profits and so on.

It seems that the current trend in many jurisdictions is to depend on an administrative regime to deter insider dealing and market abuse. It can be observed that in many jurisdictions, there is agreement that an administrative regime is more efficient than a criminal regime. This is also the case in the DIFC, which has an administrative regime against market misconduct.

Sanctions should be regarded as the last resort. Since prevention is better than cure, there also should be preventive measures besides the criminal and administrative sanctions. We discussed the position in the US of the Securities and Exchange Act 1934 in Section 16(b), which was dedicated to discouraging insider dealing through disclosure. Obligating issuers to make a timely disclosure of inside information is a practical measure to keep insider

dealing to a minimum. In fact, it is according to this rationale that modern financial market regulations have extended the obligations of timely disclosure.

There are other essential measures that should be introduced to discourage insider dealing in order to maintain a transparent and informed market. It is important to obligate financial institutions to have in place arrangements that ensure the confidentiality of inside information, for example, Chinese walls.

International standards

At the present time, the national jurisdiction of any country is expected to implement standards adopted internationally or regionally. The objective of such standards can be either to reach legal/economic harmonization or even to function as optional guidance for jurisdictions. If we are to consider the EU directives as mandatory standards, we can say that the regulation of insider dealing in the UK has reflected a kind of international standard. In this case, implementing the standards has been obligatory and aimed at reaching legal/economic harmonization. On the other hand, the optional benchmark to international standards aims at gaining the confidence of investors. The laws and regulations of the DIFC have been promulgated taking into consideration the establishment of a world-class regulatory environment. There is apparently a trend of regulatory competition or the so-called 'race to the top' between jurisdictions. Implementation of international standards in this case aims at providing an orderly market in order to attract investments.

The experience of the US and the UK in many areas has been internationally influential and considered as best practice. This is not to say that the regulation of insider dealing in the two countries has no faults. It has been indicated that the antifraud rules in the US, although being the first of their kind, have not been embraced by other jurisdictions.

One area that needs to be decided by officials in the UAE is whether there should be a plan to move financial regulation in the country closer to international standards. In the limited area of the DIFC, there is undoubtedly a plan to provide a world-class regulatory environment.

It should also be clear that this comparative study would not argue that the UAE jurisdiction should implement best practices in the world. It is rather to reach reasonable recommendations for reform of the UAE law. On the basis that the applied study aimed at indicating certain problematic areas and the comparative study aimed at looking at the

experiences of other countries, it can be said that insider dealing regulation in the UAE is behind the expectations of investors. The current regulatory environment in the UAE local markets is scrutinized in a number of areas. The applied study indicated there was an underachievement in investor confidence, market informativeness, transparency and disclosure, clarity of regulations and so on. Thus, regardless of the aim to bring the regulatory system closer to international standards, financial market regulation in the UAE should be reasonably improved to provide a better environment for investments.³⁵⁴

The policy of regulation

the policy of regulating insider dealing was indicated in Chapter One. The discussion revealed the dispute regarding the rationale underlying the regulation of insider dealing. Seemingly, one of the more convincing arguments was that insider dealing on the basis of material non-public information should be regulated because it has a negative effect on the market. However, in many jurisdictions, the answer to why there is a need to regulate insider dealing is still not clear-cut. There was a discussion of the attitude of the SEC towards insider dealing. The ‘disclose or abstain’ rule invented by the SEC is based on the premise of market informativeness, which means that all investors should have access to the information. Nevertheless, courts in the US rejected this reading in favour of reading Rule 10b-5 under fiduciary duties. There has been a discrepancy regarding the policy of regulation. On the other hand, It was indicated how the EU Directives clearly state the rationale underlying the regulation of insider dealing. In brief, the EU directives justified the regulation of insider dealing to ensure the integrity of financial markets and to enhance investor confidence in those markets.

One observation from this discussion is that in jurisdictions similar to that of the UK, the clear determination of the policy of regulation is thought to help the regulator and the courts to enforce the law since the purpose of the law is clear, while in the US, the courts disagreed with the SEC and could not find in the legislative history that supports a wide application of Rule 10b-5 to prohibit tippees, for instance. Another observation is that some precedents in the US should be read in the light of the dispute regarding the policy of regulation. Some judicial precedents in the US were decided on the basis of fiduciary duties or even on the basis of misappropriation theory. The law of fiduciary duties and the

³⁵⁴ See above heading: A summary of the results of the applied study.

misappropriation of information have not developed in the same manner in other jurisdictions.

Chapter 5: functional comparison of the regulation of insider dealing

Introduction

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Widening the concept of ‘Insider’

Primary insiders

Traditional insiders

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Secondary insiders (tippees)

Part 2 inside information

The definition of ‘inside information’

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Timely disclosure of inside information

The regulation of the ‘disclosure and control of inside information’

Legal uncertainty and providing examples

Issuer’s responsibility of identifying inside information

When to disclose inside information

Holding announcement

Delaying disclosure of information

Selective disclosure

Control of inside information

Conclusion

Introduction

While chapter four provided a ‘macro-comparison’ approach to the regulation of insider dealing, there needed to be a ‘micro-comparison’ approach to the particular rules relating to insider dealing. There are various functions of comparative law. The aim is to build up recommended new rules for the UAE law through looking at the advantages and disadvantages of the laws compared.

The comparative discussion of the systems in outline in chapter 4 aims at exploring the background and the nature of the systems. This chapter constitutes a comparative legal study, but it has a specific methodology and objectives.

The second and third chapters aimed at demonstrating that insider dealing as a problem exists in the local markets of the UAE. The thesis attempted to prove that there are regulatory shortcomings in financial markets in the UAE. A background to the evolution of financial markets and their current regulatory situation was provided in the second chapter. The applied study, in its turn, supported the proposition that there are regulatory shortcomings in local financial markets. The most obvious of these are shortcomings in transparency, disclosure of information, protection of the market and investors, and regulating insider dealing. Thus, it can be said that insider dealing is a problem in the UAE markets, as it is a problem in any other market whether developed or emergent. The problem is universal, because in any market which facilitates trading, information plays a vital role in directing prices to be fair. There are always instances in which ‘insiders’ have access to ‘inside information’ which is not available to other investors. The result is that the problem of insider dealing is ‘universal’. That is notwithstanding that the nature and degree of the problem varies from one market to another. It is acknowledged that the function of the law is to provide a solution to the ‘legal problem’ and that this could be achieved in different legal systems by different means. The solutions found by different legal systems can be similar if the ‘legal problem’ is ‘universal’. This implies the existence of ‘universal principles of law’, which are formulated into different terminology in different jurisdictions.³⁵⁵

The proposition that there could be ‘universal principles of law’ can also be supported by the findings of the applied study. The results of this show that investors think that the

³⁵⁵ RALF MICHAELS ‘The Functional Method of Comparative Law’ *Duke Law School Working Paper Series* Paper 26, Year 2005. p.8.

following are respectively the most important regulatory principles: ‘financial markets should be transparent and issuers should make timely disclosure of any inside information’; ‘investors in financial markets should be put on an equal footing and their rights should be protected’; and ‘there should be an implementation of international standards of regulation in the local financial markets of any country’.

On this basis, it can be argued that there is similarity between the principles underlying the regulation of insider dealing in different jurisdictions. That is because the problem of insider dealing is ‘universal’. However, it remains true that there are differences between jurisdictions in relation to the rules adopted to regulate insider dealing. Comparative law is the appropriate methodology to compare the different means found by different jurisdictions to respond to the same problem. In fact, comparison is one of the most important scientific approaches. It is difficult to imagine how a national legal system could be improved without shedding light on its shortcomings through comparison.³⁵⁶

It seemed appropriate to determine the ‘function’ to be fulfilled by the comparative study which serves the purpose of this chapter. In other words, according to the functional method of comparative law, there are specific functions to be served by a comparative study. For the purposes of this study, it appears that the “building of a system” is the most important function. The poor drafting of regulations in the UAE have been discussed earlier.³⁵⁷ This was a result of the drafters ignoring comparative law as a practical method of introducing a better law, which simultaneously serves better the needs of the national system. The “building of a system” is the main function to be served by the functional comparison in this chapter. It is clear that evaluating and criticising the comparative systems are the way in which appropriate solutions can be reached.³⁵⁸

The following parts will identify the crucial functions to be fulfilled in an effective system of regulation of insider dealing. This is especially important in answering the central questions regarding the regulation of insider dealing: the definition of an insider; the definition of inside information; the definitions of related concepts and the regulation of timely disclosure.

³⁵⁶ R. H. GRAVESON ‘Philosophy and Function in Comparative Law’ (1958) 7 *The International and Comparative Law Quarterly* 649. pp.652-3.

³⁵⁷ See above heading: Insider dealing regulation in local financial markets in the UAE.

³⁵⁸ RALF MICHAELS ‘The Functional Method of Comparative Law’ *Duke Law School Working Paper Series* Paper 26, Year 2005. p.25.

Part 1 Insider

The definition of an 'insider'

...The problem of the regulation of insider dealing has taken several stages in developed jurisdictions. In the first stage, an insider was only one who possesses inside information due to his status or profession. Then the net was widened; the relatives were included as insiders. In the last stage, the term included all those who possess inside information. How did they possess it? From a friend, overhearing it in a café? From someone who by the nature of his employment (for example an electrician) heard the information? He is not from the company but is an insider. Widening the concept of the insider in several stages should be represented in your thesis in a way which reflects the legislative development of this point. The harm in this act does not depend on whether the insider is someone from the company.

Q – What about the SCA regulations of this point?

A – Under the SCA regulations only those who possess information because of their status or profession can be insiders. There is another Article...which states that a person cannot derive personal benefit for himself or someone else, but we cannot say that relatives can be included in this Article... But if we widen the net to the third stage, it will include those insiders due to their status, profession, relatives and anyone else.

Q – What do you think about the limited nature of the rules in the SCA?

A – There should be a wider net for determining insiders, especially in our societies. In our culture, information is disclosed easily. Also, in companies in this country individuals have positions on several boards of directors. At the same time they are investors in securities. The information is easily passed and everyone can deal on the basis of it. It is also easy to evade the rules if they are limited. An insider can deal in his wife's or children's accounts if they are not included in the regulation. He can also deal in the account of his company, or pass the information to a friend and then share the profits. This can be found here more than anywhere else. The nature of relationships in this society determines that there is insider dealing in this country.

...

There is certainly insider dealing activities. It is also because a lot of the companies in this country have a family characteristic, in spite of their transformation into public companies. Member of the board of directors can be relatives. This makes it easy to pass information from one person to another.

...

Q – If the developed countries widened the definition of an insider step by step, should we also widen it gradually?

A – Not necessarily. We take several stages. We should begin where the other has arrived. There were loopholes in the legislation in other countries; we do not have to make the same mistakes.³⁵⁹

³⁵⁹ TOJAN AL SHURIDEH, Legal Consultant, Securities and Commodities Authority *Interview Transcript*. See Appendix 6, Interview (3).

In order to provide certainty in the rules regulating insider dealing, there has to be a clear definition of the elements in the action of “insider dealing”. The most important elements are “insider” and “inside information”. It is no exaggeration to say that the definition of these two terms is the core point of the problem of studying the law of insider dealing.

As regard the definition of an ‘insider’, it is apparent that the US model revealed the complexity and, at the same time, the desirability of defining the term. The problem of determining an ‘insider’ in the US regulation was discussed in depth in chapter four. The discussion will not be repeated in this chapter, except to indicate how case law solved similar problems intended to be solved by statutes. It is the US experience which put other jurisdictions on the right track, leading them to introduce statutory definitions. Yet, introducing a statutory definition, while it meets the need for legal certainty, raises a number of other legal problems which could be faced in practice. The term ‘insider’ does not present a problem until one comes to evaluate the statutory definition of it.

In general, securities laws appear to be divided into two approaches. Legal definitions of what constitutes an ‘insider’ for the purpose of prohibiting insider dealing are based on either a ‘person connection’ approach or an ‘information connection’ approach. The ‘person connection’ approach defines an insider by depending on the criterion of the relationship of the person to the issuer of the securities. In contrast, the ‘information connection’ approach considers any person who possesses inside information relating to the issuer as an insider, regardless of his/her relationship to the issuer.³⁶⁰ It may appear that subjecting all those who possess inside information to the ‘information connection’ approach will leave no loophole in legislation. However, such a broad definition may be unfair, since people who are without proper knowledge of the status of the information may be subjected to the prohibition. In other words, the ‘person connection’ approach takes into consideration the means of accessing inside information, and usually distinguishes between the ‘primary insider’ and the ‘secondary insider’ for the purposes of requiring a certain degree of knowledge of the information for each category (as will be explained). Therefore, it seems that a ‘person connection’ approach is appropriate in defining an insider, through differentiating between ‘primary’ and ‘secondary’ insiders. It can be said that, in general, the US, UK and DIFC regulations all adopt a ‘person connection’ approach

³⁶⁰ Z. SU AND M. A. BERKAHN ‘The Definition of “Insider” in Section 3 of the Securities Markets Act 1988: A Review and Comparison with other Jurisdictions’ School of Accountancy, Massey University, New Zealand, Discussion Paper Series 218, November 2003. p.1.

in defining an insider. That is, insiders are determined by a connection of one kind or another to the source of information. However, the recent trend in the regulation of insider dealing has been one of widening the definition of insiders in order to avoid any loopholes. This involves adopting a definition with elements of both approaches.

Widening the concept of 'Insider'

The classic notion of an insider is that where a director of an issuer obtains from a board meeting material information which will have a significant effect on the price of the issuer's securities, and then deals in the related securities on the basis of the information he possesses before it is made public. In this case, the director exploits his position and takes advantage of the inside information that he learnt by virtue of his position. The director may also encourage another person to deal on the basis of inside information or disclose the information to that person. The director also exploits his position in such circumstances, and he knows that the other person is likely to deal on the basis of inside information because he is advantaged over other uninformed dealers. The situation is no different where the insider aims to avoid a loss, not to make a profit. The director takes advantage of inside information and it does not matter whether he uses it to make a profit or to avoid a loss, since in both cases he is advantaged over other uninformed dealers. The term 'insider' was traditionally used to indicate those who were 'inside' a corporation and thus had access to 'inside information', for example, directors, employees and major shareholders. However, this traditional notion, based on general legal provisions, departed a long time ago. The currently consistent rationale of regulating insider dealing is the maintenance of a fair and transparent market, the maintenance of investor confidence in the market and putting investors on an equal footing in terms of information. This is one of the main premises of the thesis. It is not the current position in the US, but the abandoned 'disclose or abstain' rule was based on this premise. The notion that the philosophy on which regulating insider dealing is based results in the scope of the regulation has been discussed. Where the central justification is protecting the informative nature of the market, this is represented as a departure from the traditional concept of regarding insider dealing as a breach of fiduciary relationships.

This classic example had been influential in attempts to prohibit insider dealing. It is supported by attempts to attach fiduciary obligations to the insider under common law. In

addition, Section 16(b) of the Securities and Exchange Act 1934 in the US makes it clear that the classic notion is dominant.³⁶¹

The classic concept appeared to be limited in posing a deterrent prohibition to insider dealing. In practice, it is not only directors who discover inside information. Rather, it is true that many other persons can be deemed insiders, since they have regular access to inside information, sometimes more than the directors themselves. If directors, officers and employees are prohibited from insider dealing, they can indirectly benefit from the information by passing it on to others. Why then, should prohibition not be widened to encompass other persons who are likely to have access to inside information and to use it? It is this point which presented the difficulty in the US, when Rule 10b-5 was broadly interpreted to prohibit ‘corporate outsiders’ from insider dealing.

The response to this problem has been to introduce into statutory definition two groups of insiders, ‘primary’ and ‘secondary’ insiders. It is crucial to evaluate to what degree comparative law succeeded in fulfilling the function of defining an insider under these two main categories. The comparison is between the following laws: the CJA 1993, UK, the FSMA 2000, UK, the Markets Law 12 of 2004, DIFC and reference to the US case law.

It is challenging to explain the laws of the DIFC. This is because of the complex terms in these laws and the fact that academic references in the field are scarce. However, there has been considerable work in comparative jurisdictions, and this can be approached whenever appropriate.

Primary insiders

To define insider dealing, it is essential to define the central word, namely “insider”. For the purpose of simplifying the discussion, ‘primary insiders’ can be divided into ‘traditional insiders’ and ‘access insiders’. ‘Traditional insiders’ are those who, because of their status, are more likely to possess inside information. ‘Access insiders’ are those who, because of their function, profession or activities, have a relationship with the issuer which makes them likely to have access to inside information.

Traditional insiders

Jurisdiction	Related legal rules
UK	CJA 1993, Section 57(2)(a)(i) ...a person has information from an inside source if and only if-

³⁶¹ Explained in-depth in Chapter four, see heading: The regulation of insider dealing in the US

	(a) he has it through- (i) being a director, employee or shareholder of an issuer of securities;
UK	FSMA 2000, Section 118B(a) and (b) ...an insider is any person who has inside information- (a) as a result of his membership of an administrative, management or supervisory body of an issuer of qualifying investments, (b) as a result of his holding in the capital of an issuer of qualifying investments,
DIFC	Markets Law, DIFC Law No.12 of 2004, Section (45)(2)(a) ...a person that is a director, officer, employee, affiliate, Associate or adviser of: (i) the relevant Reporting Entity; (ii) a person that is proposing to make a Takeover Offer under Part 7 for the shares of the Reporting Entity; or (iii) a person that is proposing to be involved in a takeover with the Reporting Entity;
US	Case law.

In the UK, the law of insider dealing is fragmented. Under the CJA 1993 and the FSMA 2000, there is a dual definition of ‘insider’ and ‘inside information’. It is proper to compare the insider dealing provisions under the new Section 118 of the FSMA 2000 with the provisions under the CJA 1993. The most important criteria for comparison are in the area of the scope of the definitions of ‘insider’ and ‘inside information’. Nevertheless, initially it can be said that the two definitions of ‘insider’ under the CJA 1993 and the FSMA 2000 are in most instances similar. The definition of the ‘primary insider’ category, especially, is very similar under both statutes. The reason for the similarity is that the two definitions of ‘primary insider’ (those of the CJA 1993 and of the FSMA 2000) were the result of the implementation of two similar European definitions of the term. The definition of ‘primary insider’ under the CJA 1993 is derived from implementing Article 2(1) of the Insider Dealing Directive.³⁶² On the other hand, the definition of ‘primary insider’ under the FSMA 2000 is derived from the related definition in the Market Abuse Directive. The definition under the Market Abuse Directive is the pertinent one. In turn, this directive listed insiders

³⁶² Directive 89/592/EEC coordinating regulations on insider dealing (Insider Dealing Directive) [1989] OJ L334/30.

Article 2(1):

Each member state shall prohibit any person who:

- by virtue of his membership of the administrative, management or supervisory bodies of the issuer,
- by virtue of his holding in the capital of the issuer, or
- because he has access to such information by virtue of the exercise of his employment, profession or duties, possesses inside information from taking advantage of that information...

in Article 2(1).³⁶³ It appears that under both the Insider Dealing Directive and the Market Abuse Directive the list of ‘primary insiders’ is almost identical. Consequently, the list of ‘primary insiders’ under the CJA 1993 and the FSMA 2000 is also almost identical.³⁶⁴ The main difference is the addition of a new means of access to inside information, which is ‘by virtue of criminal activities’. The addition is directed to prevent the involvement of organised crime and terrorist groups in financial markets in order to conceal their illegal activities and direct the profits to their activities.³⁶⁵

That the two definitions of ‘primary insiders’ in the CJA 1993 and the FSMA 2000 are very similar, however, is not to argue that they are identical. The CJA 1993 stated “director, employee or shareholder” as ‘primary insiders’. On the other hand, the UK implementation of the Market Abuse Directive in this area was “verbatim or copy out”.³⁶⁶ Therefore, it stated the same definition of the related directive as the one appearing in the above table.

‘Traditional insiders’ under the CJA 1993 are directors, employees or shareholders, while under the FSMA 2000 they are members of an administrative, management or supervisory body, or shareholders. It seems that the only confusion is whether under the FSMA 2000 “members of an administrative, management or supervisory body” encompasses all the directors and employees. It might be said that there could be cases which cannot be considered as being in an administrative or management position, for example a printer or a representative. However, as will be explained, the category of ‘access insiders’ encompasses all the employees of the company who, by virtue of their employment, possess inside information.³⁶⁷ Therefore, there is no loophole in considering an employee as a ‘primary insider’.

³⁶³ Market Abuse Directive, Article 2(1)...

The first subparagraph shall apply to any person who possesses that information:

- (a) by virtue of his membership of the administrative, management or supervisory bodies of the issuer; or
- (b) by virtue of his holding in the capital of the issuer; or
- (c) by virtue of his having access to the information through the exercise of his employment, profession or duties; or
- (d) by virtue of his criminal activities.

³⁶⁴ See KAREN CONNOLLY ‘European Union: Implementing Measures under the Market Abuse Directive’ (2002) 4 *Journal of International Financial Markets* 99.

³⁶⁵ Market Abuse Directive, Recitals 17 and 14.

³⁶⁶ JANE WELCH, MATTHIAS PANNIER, EDUARDO BARRACHINO, JAN BERND AND PHILIP LEDEBOER ‘Comparative Implementation of EU Directives (I) – Insider Dealing and Market Abuse’ (2005) City Research Series, Number Eight, *The British Institute of International and Comparative Law*.

³⁶⁷ MICHAEL ASHE ‘The Directive on Insider Dealing’ (1992) 13 *Company Lawyer* 15. p.17.

Both the CJA 1993 and the FSMA 2000 confer automatic insider status on individuals who may have inside information by virtue of their status. Thus, amongst the primary insiders, there are those who have traditionally been considered as more likely to possess inside information because of their status or relationship to the issuer. But the CJA 1993 also confers the same automatic status on employees, irrespective of their position, since it is not a condition that they occupy a position which could reasonably be expected to gain them access to inside information. In this sense, it might be that under this provision an office cleaner who comes across inside information could be regarded as an insider for the purposes of this act, without regard to his position.³⁶⁸ The position of both acts is that automatic insider status is also conferred on the shareholders of the issuer's securities, irrespective of the percentage of their shareholding. There is no lower threshold for the shareholding and no requirement of a controlling shareholding; although in practice the larger shareholder is more likely to have access to inside information, and to therefore be an insider.

In the US, as was discussed in-depth earlier, it was not difficult to attach responsibility to 'traditional insiders'. The basis of responsibility was the relationship of directors, officers and controlling shareholders to the issuer, which gave rise to fiduciary duties. In the US it was acknowledged that such individuals breach their fiduciary duties when dealing on the basis of inside information. In addition, Section 16(b) of the Securities and Exchange Act 1934 is dedicated to the prohibition of unfair use of information by any director or officer, or by a shareholder with more than 10% of the shares. It is apparent that this section was based on the classic notion that considers 'insiders' as those who have a relationship to the issuer.³⁶⁹

In the DIFC, DIFC Law No.12 of 2004, Section (45) (2) provides a definition of "a person in a special relationship". The definition of this term is equivalent to defining an 'insider'. Insiders can be divided into two categories, 'primary insiders' and 'secondary insiders', as most of the recognized jurisdictions determine.

Contrary to the position in the UK, it is difficult to say that there is a category of 'traditional insiders' in the DIFC. It is apparent that the DIFC law attempted to adopt a wide definition of 'primary insiders'. In the DIFC, a director, officer, employee, affiliate,

³⁶⁸ KEITH WOTHERSPOON 'Insider Dealing: The New Law: Part V of the Criminal Justice Act 1993' (1994) 57 *The Modern Law Review* 419. p.425.

³⁶⁹ The law of the US was explained in-depth in Chapter four, see heading: The regulation of insider dealing in the US

associate or adviser of the relevant reporting entity can be an insider. Directors and employees are the classic examples of insiders. This rule, nevertheless, expands classic insiders to include affiliates, associates or advisers. The question that arises is whether it is necessary to confer affiliates, associates or advisers the same status as directors in terms of being considered insiders. It is acknowledged that in reality there are complex relationships of ownership and control between corporations. It is difficult to imagine that there can be an 'issuer' or a 'reporting entity' which has no relationship of any kind either to a subsidiary, a holding, a group of companies or a business associate. However, attempting to introduce all the particular situations in which a person can be considered an insider is not achievable in law. In other words, the DIFC law would have been much clearer if insiders were categorized under a breadth criterion.

The above-mentioned legal problem can be simplified using the following example. A person (A) was the secretary of company (1). (A) was aware of the material problems relating to company (2) a subsidiary of company (1) because of the relationship between the two companies which normally resulted in a flow of information between them. (A) was in possession of relevant negative information concerning company (2). He sold the shares of company (2). Following the announcement of the negative information, the share price dropped significantly. By selling the shares when he did while in possession of information not generally available (A) avoided a loss.³⁷⁰ According to the facts of this case, (A) possessed inside information relating to the subsidiary company, not to the controlling company employing him. If this case had been decided under the DIFC law, (A) would be considered an insider, because he is an affiliate or associate of the source of the information. However, in the UK (A) would be more easily considered an 'access insider', because he accessed inside information by virtue of his employment. This means that the two laws fulfill the same function. However, the criterion under the UK law seems to be sufficiently broad and much easier for business to comply with. The DIFC law divides insiders into complicated sub-categories.

The definition of an insider is made more complicated by DIFC Law No.12 of 2004, Section (45) (2) by indicating the situation in a takeover. According to this article, the following are considered as having the same status of "director" as the issuer: under (a) (ii)

³⁷⁰ The facts of this example are, to a certain degree, similar to those of the case; FINANCIAL SERVICES AUTHORITY, Final Notice, *Robert Middlemiss*, 10 February 2004. pp.2-5. The case was decided under 'misuse of information' rather than 'insider dealing' provisions.

a director, officer, employee, affiliate, associate or adviser of a person that is proposing to make a takeover offer for the shares of the reporting entity, or, under (iii), proposing to be involved in a takeover with the reporting entity. It is acknowledged that in takeovers there is material market information which should not be exploited by insiders to deal for their own benefit. However, it can be questioned whether this rule makes it easier to attach responsibilities to those who have access to material takeover information.

This provision is comparable to the American case in 1980, *Chiarella v. United States*³⁷¹, where a printer handling corporate takeover bids deduced the identities of the companies and dealt in their stock without disclosing information about the takeovers. The financial printer was prosecuted on the grounds that he used information regarding tender offers and a merger, and bought stocks in the targeted companies. The Supreme Court reversed the conviction, holding that dealing on the basis of material non-public information is not in itself a breach of anti-fraud provisions and the printer was not obliged to a duty of disclosure to the target shareholders. Due to the legal loophole, the instant response of the SEC to *Chiarella* was its adoption of Rule 14e-3 under Section 14(e) of the Securities and Exchange Act 1934. This rule was designed to prohibit insiders of the offeror and the target companies from revealing material information about a tender offer to those who are expected to trade on the basis of such information. The rule also prohibits those ‘outsiders’ who possess material information regarding a tender offer by another person from dealing in the target company’s securities.

In the US, the adoption of Rule 14e-3 was necessary to avoid a legal gap. The question arises whether it was essential for the DIFC law to dedicate a category to defining insiders to inside information relating to takeovers. The DIFC law attempts to encompass directors, officers, employees, affiliates, associates or advisers of the offeror or a company involved in takeover. In fact, it is difficult to imagine how these groups of insiders possess inside information other than by virtue of their employment, profession or duties. In the UK, under the Company Securities (Insider Dealing) Act 1985, the definition of insider in Section 1(5) included a specific category of insiders who are contemplating takeovers in a particular capacity. When this act was replaced by the adoption of the CJA 1993, the specific category of takeover insiders was abandoned. However, those contemplating takeovers were within the scope of ‘access insiders’ in the definition under the CJA

³⁷¹ *Chiarella v. United States*, 445 U.S. 222 (1980).

1993.³⁷² Thus, it could be argued that those who possess inside information relating to takeovers could be encompassed within the category of ‘access insiders’. Again, the more broadly based category of ‘access insiders’ is easier for the regulator and businesses to comply with.

It could be a valid justification that introducing descriptive categories of insiders under the DIFC was necessary because there were no legal or judicial precedents. However, this aim was not achieved by the law. On the contrary, the DIFC law, by dividing insiders into particular sub-groups, narrowed the scope of insiders. This will be discussed under ‘secondary insiders’.

One difficulty in defining insiders is that of defining the way in which they possess inside information. In the UK, under the CJA 1993, the first category of insider, the ‘traditional insider’ possesses inside information if he “has it through being” a director, employee or shareholder of an issuer of securities. The problem here is that the law seems to require a causal link between the individual’s being in the specific position and his/her possession of inside information. If (A) was a window cleaner who had inside information while cleaning the issuer’s windows, it could be claimed that he gained the information ‘incidentally’ while he was cleaning rather than “through being” an employee.³⁷³ Another potential loophole is seen in this example: if an employee (A) heard inside information out of the hours of his duty, would it be possible to say that he had it “through being” an employee of the issuer? It is, therefore, thought that the requirement of “has it through being” could be a loophole in the law.³⁷⁴

The FSMA 2000 replaced the phrase ‘through being’ with ‘as a result of’. Thus, an insider is a director, employee or a shareholder who possess inside information “as a result of” his being such. It could be argued that it is still not clear why the law should require a certain way in which an insider might have inside information. This is especially so in relation to primary insiders who are most likely to possess inside information and are, in most cases, supposed to know the status of the information.

³⁷² BRENDA HANNIGAN ‘Regulating Insider Dealing – The EEC Dimension’ (1989) 4 *Journal of International Banking Law* 11. p.12.

³⁷³ MICHAEL ASHE ‘Who is an Insider?’ in BARRY RIDER AND MICHAEL ASHE (Eds.) *The Fiduciary, the Insider and the Conflict: a Compendium of Essays* (Dublin: Brehon Sweet & Maxwell, 1995). p.77.

³⁷⁴ M. STAMP AND T. JAGGERS ‘United Kingdom’ in M. STAMP AND T. JAGGERS (eds.) *International Insider Dealing* (Old Woking: City & Financial Publ., c2005). pp.199-20.

The above-mentioned difficulty seems to be avoided in the DIFC law. When the rules were combined, the prohibition against a director would be read as follows: “a director of the relevant reporting entity shall not deal in investments of or relating to the reporting entity if the person possesses material information”. It is apparent that in the DIFC it is not required that the primary insiders possess inside information “by virtue” of their position, employment...etc. It means that their merely being in the determined categories, and in possession of information, is sufficient for them to be regarded as primary insiders. There is no requirement of a causal link between their being in such a position and their possession of the inside information. This means that primary insiders are under a duty of care to assess the information in their possession. This is also expected to avoid a loophole in the following example. (A) is a director who had access to inside information due to his position. (A) revealed the inside information in a café conversation and (B), who was an employee of the same issuer, overheard the information. In this case, it can be said that (B) did not access the inside information by virtue of his employment. However, it is not clear that (B) would benefit from any loophole under the DIFC law, because there is no requirement of a certain way in which he should gain the information. His/her mere possession of the information is sufficient to consider him/her an insider.

Access insiders

Jurisdiction	Related legal rules
UK	<p>CJA 1993, Section 57(2)(a)(ii) ...a person has information from an inside source if and only if-</p> <p>(a) he has it through-</p> <p>...</p> <p>(ii) having access to the information by virtue of his employment, office or profession;</p>
UK	<p>FSMA 2000, Section 118B(c) and (d) ...an insider is any person who has inside information-</p> <p>...</p> <p>(c) as a result of having access to the information through the exercise of his employment, profession or duties, (d) as a result of his criminal activities, or</p>
DIFC	<p>Markets Law, DIFC Law No.12 of 2004, Section (45)(2)(b), (c) and (d) (b) a person that is engaging in or proposes to engage in any business or professional activity with or on behalf of the Reporting Entity or with or on behalf of a person described in Article 45(2) (a)(ii) or (iii); (c) a person that is a director, officer or employee of the entity</p>

	described in Article 45(2)(b); (d) a person that learned of the material information with respect to the Reporting Entity while the person came within Article 45(2)(a), (b) or (c); or
US	Case law.

Another important category of ‘primary insider’ is that of those who do not have a relationship with the issuer, but have a connection because of the services they provide. This group includes lawyers, accountants and investment bankers who have an important role in making decisions for the issuer, and therefore have access to material information. In some circumstances they are expected to have knowledge of the materiality of the information and to be subject to the temptation to use it. For purposes of explanation, this group is called ‘access insiders’. It is crucial to note that under statutory definition, which widens the scope of insiders, ‘access insiders’ need not have a connection or a relationship with the issuer when they have access to inside information relating to the issuer.³⁷⁵ This is the trend in the statutes. They moved from the old concept that an insider should have a connection with the company and adopted a rather wider definition of the term insider.

The US experience revealed the degree to which it is difficult to hold “access insiders” liable in the absence of a statute clearly defining them as insiders. It was considered a victory for the ‘misappropriation theory’ in defining Rule 10b-5 when the Supreme Court considered O’Hagan as an insider in the case of *United States v. O’Hagan*.³⁷⁶ In fact, O’Hagan would easily be considered an “access insider” under UK law. It was not so easy to attach responsibility to him in the US. O’Hagan was a partner in Dorsey and Whitney, a law firm which represented Grand Metropolitan PLC with regard to a potential tender offer for the Pillsbury Company’s common stock. O’Hagan did no work in the representation but learned of the potential deal. He dealt in options in Pillsbury stock and made a profit when Grand Met made public its tender offer and the price of Pillsbury stock rose considerably. O’Hagan argued that his conduct did not amount to fraud because he owed no fiduciary duty to Pillsbury. It is clear that this point was the difficulty faced by the SEC and courts in the US. The Supreme Court rejected his contention and upheld his conviction. The Court

³⁷⁵ KEITH WOTHERSPOON ‘Insider Dealing: The New Law: Part V of the Criminal Justice Act 1993’ (1994) 57 *The Modern Law Review* 419. p.425.

³⁷⁶ *UNITED STATES v. O’Hagan*, 92 F.3d 612 (8th Cir. 1996). In the Supreme Court *United States v. O’Hagan*, 117 S.Ct. 2199, 2211 (1997).

adopted misappropriation theory to attach responsibility to a corporate “outsider” who violates Section 10(b) and Rule 10b-5.³⁷⁷

Contrary to the US law, the UK adopted a statutory definition of an insider. The scope of insiders is wider in a statutory definition, which is based on the rationale of justifying the regulation of insider dealing on informational advantage, rather than on the relationship between the insider and the issuer. Thus, the CJA 1993 expands the group of primary insiders to include ‘access insiders’, who have access to the information by virtue of their employment, office or profession. This provision is expected to include lawyers, bankers, auditors, consultants and professionals who may have access to inside information. The FSMA 2000 introduced a similar list of ‘access insiders’. However, the term ‘by office’ was replaced by the term ‘by duties’. It can be said that in both cases the provision directed to access insiders is sufficiently broad to include public employee who may have access to inside information by virtue of their official ‘office’ or ‘duties’. In both cases it is expected that the same function will be fulfilled. This is to encompass public servants who may have access to inside information by virtue of their ‘office’ or ‘duties’.³⁷⁸

The main difference between the CJA 1993 and the FSMA 2000 lists of ‘primary insiders’ is the addition of a new means of access to inside information, which is ‘by virtue of criminal activities’. Introducing this new means of access was necessary to implement the Market Abuse Directive.³⁷⁹ It is thought that the addition is directed to preventing the involvement of organised crime and terrorist groups in financial markets, in order to conceal their illegal activities and direct the profits to these activities. It is also possible that this addition is intended to encompass instances of theft of information or any other criminal activities aimed at gaining access to inside information.³⁸⁰ It is acknowledged that there are significant concerns regarding terrorist groups’ involvement in the financial

³⁷⁷ *United States v. O'Hagan*, 117 S.Ct. 2199, 2211 (1997). at 2209.

³⁷⁸ KEITH WOTHERSPOON ‘Insider Dealing: The New Law: Part V of the Criminal Justice Act 1993’ (1994) 57 *The Modern Law Review* 419. pp.425-6.

³⁷⁹ Market Abuse Directive, Recital 14:

This Directive meets the concerns expressed by the Member States following the terrorist attacks on 11 September 2001, as regards the fight against financing terrorist activities.

Recital 17:

As regards insider dealing, account should be taken of cases where inside information originates not from a profession or function but from criminal activities, the preparation or execution of which could have a significant effect on the prices of one or more financial instrument or on price formation in the regulated market as such.

³⁸⁰ AVGOULEAS, EMILIOS ‘EC Securities Regulation, a Single Regime for an Integrated Securities Market: Harmonised We Stand, Harmonised We Fail? Part 2’ (2007) 22 *Journal of International Banking Law and Regulation* 153. p.154.

system. Although there is involvement of organised crime and terrorist groups in the financial system, but confronting their concealment of illegal activities and the financing of their activities is the function of anti-money laundering laws.³⁸¹ It is difficult to imagine that this sub-section will fulfill its ambitious functions such as confronting terrorist activities. Moreover, the addition of this sub-section could also be criticized if the aim was to confront theft of information, since in relation to the latter it should be confronted by criminal law policy. In brief, there seemed to be a confusion in the aims of the regulation of insider dealing when ‘as a result of his criminal activities’ was added as a means of access to inside information.

The facts of the following case show how an insider could access inside information ‘as a result of his criminal activities’. Mr David Isaacs was an experienced private investor. He had no connection to Trafficmaster plc and used internet bulletin boards to exchange information. He had an acquaintance who was an employee of Trafficmaster. Trafficmaster held an internal management meeting in which minutes were produced and distributed internally. The minutes included important information regarding certain transactions entered into, or to be entered into, by Trafficmaster. Mr Isaacs visited his acquaintance’s house. He saw and memorized the minutes while his acquaintance was out of the room. Mr Isaacs posted the information on an internet bulletin board. He also purchased shares in Trafficmaster.³⁸²

In the above case it was argued that Mr Isaacs had access to the information ‘as a result of his criminal activities’. It is apparent that he had access to the information without the consent of his acquaintance. He also breached the privacy of his acquaintance and accessed private information. However, it might be difficult to decide that his action was a criminal activity. Is it to be decided under the criminal law provisions? What if a criminal court acquitted him of committing any criminal activity? This hypothesis reveals the degree of difficulty which could be faced when arguing that an insider has inside information ‘as a result of his criminal activities’. It is also ironic that catching ‘criminal insiders’ is attempted by the FSMA 2000, rather than by the criminal provisions under the CJA 1993.

³⁸¹ It is indicated that the Market Abuse Directive was adopted in the aftermath of the terrorist attacks of 11 September 2001, which made the international community reconsider combating financing terrorism. The UAE, in its turn, adopted a whole body of laws and regulations to combat money laundering and financing terrorism.

³⁸² FINANCIAL SERVICES AUTHORITY, Final Notice, David Isaacs, 28 February 2005. pp.3-6. The FSA found that Mr Isaacs’ behaviour in terms of dissemination of information relating to Trafficmaster fell within the scope of the original Section 118(1)(b) and 118(2)(a) of the FSMA 2000. His actions in disseminating information on the internet amounted to a ‘misuse of information’.

In any case, it can be argued that that having access to inside information ‘as a result of his criminal activities’ could be encompassed by the ‘secondary insider’ category. He “has inside information which he has obtained by other means and which he knows, or could reasonably be expected to know, is inside information”.³⁸³

In the DIFC, ‘access insiders’ are categorized under **(b)** a person that is engaging in or proposes to engage in any business or professional activity with or on behalf of the Reporting Entity or with or on behalf of a person described in Article 45(2) (a)(ii) or (iii); under **(c)** a person that is a director, officer or employee of the entity described in Article 45(2)(b) and under **(d)** a person that learned of the material information with respect to the Reporting Entity while the person came within Article 45(2)(a), (b) or (c).

One advantage of sub-section **(b)** is that it is accurately drafted to include not only “a person that is engaging in”, but also a person that “proposes to engage in”. The engagement could be either in business or professional activity. The latter could be a professional activity by a law or accountancy firm, where such firms and their directors and employees could have access to material information.

It is advisable that sub-sections **(b)** and **(c)** should be read jointly. Sub-section **(c)** states that “a person that is a director, officer or employee of the **entity** described in **(b)**”, while sub-section **(b)** states that “**a person** that is engaging in or proposes to engage in any business or professional activity...” Sub-section **(c)** indicates that sub-section **(b)** determines entities (meaning corporations) which are in a business or professional relationship with the issuer. The problem is that sub-section **(b)** states **a person** rather than **an entity**. One possible justification is that a ‘person’ under the DIFC laws may include a corporation.³⁸⁴ However, Article 45(2) does not determine when a ‘person’ is considered a natural person and when a ‘person’ is considered a corporation. It is confusing that a ‘person’ under sub-section **(b)** is indicated as a corporation, whereas the same term a ‘person’ under sub-section **(c)** is indicated as a director, officer or employee.

Another category of insiders is defined under sub-section **(d)** a person that learned of the material information with respect to the Reporting Entity while the person came within Article 45(2)(a), (b) or (c). It is difficult to understand who the target of this rule is. It may

³⁸³ This will be discussed below, see heading: Secondary insiders (tippees).

³⁸⁴ “Person” has the meaning given in Article 1 of Schedule 1 to the Regulatory Law 2004, which states that: “a person includes any natural person, body corporate or body unincorporate, including a company, partnership, unincorporated association, government or state”.

be that the drafter wanted to avoid any loophole which allowed persons who learned of the material information to exploit it. There seems to be a repetition of the formerly determined categories of insiders. Sub-section (d) states: “a person that... while the person came within Article 45(2)(a), (b) or (c)”. If the person already came under the former sub-sections he is viable to be an insider. Then why should another sub-section repeat the same?

It is not overstating the case to say that the wording of sub-sections (b), (c) and (d) are closer to being a puzzle than to being clear legal rules. It is probable that these sub-sections attempt to encompass a category equivalent to ‘access insiders’. It is apparent that the law attempted to describe complex circumstances which exist in real life and result in insiders having access to inside information. It can be seen as an advantage that the law recognised the complex relations of “business or professional activities” that exist in reality. However, it is apparent that the law is dividing insiders into complicated sub-groups. This makes the rules difficult to interpret, and even more difficult for businesses to absorb. The drafters could have made it easier if they had adopted a rule similar to that of the UK (the FSMA 2000) which specifies “...persons who possess ‘inside information’ by virtue of their...(b) as a result of having access to the information through the exercise of his employment, profession or duties”. The UK law captures a wide scope of insiders. It probably encompasses all those who might be considered ‘access insiders’. It is difficult to justify why the DIFC law attempts to show that there should be a kind of a relationship between the ‘access insider’ and the issuer.

It appears that the DIFC definition of the insider is based on the principle that there should be a kind of a connection between the insider and the source of information. In other words, it is apparently a ‘person connection’ definition. This approach can be criticised for more than one reason. It is appreciated that in other jurisdictions, like the US and the UK, the definition was widened in more than one stage. However, the DIFC should have learned from such jurisdictions the importance of adopting a reasonably wide definition. In addition, the DIFC insider dealing rules come under “part 8: prevention of market misconduct”, which indicates that the rules aim to protect the market and investors through maintaining an informative market. If the aim is to protect the market and investors through maintaining an equal access to information, it is difficult to see why the law restricts the scope of insiders. If the ‘access insider’ possessed inside information because of his employment, profession or duties and he dealt in the market, the harm is perceived and it

does not matter whether there was a direct or indirect relationship between him and the issuer.

In the UK, one problem which may be faced is this: does the law require a certain way in which “access insiders” have the inside information? The problem is that the CJA 1993 requires that ‘access insiders’ have inside information “**by virtue**” of their employment, office or profession. On the other hand, the FSMA 2000 requires that ‘access insiders’ have inside information “**through the exercise**” of their employment, profession or duties. An example is that of a waiter who overhears inside information from directors while he is taking their orders. The question is whether the waiter is considered an access insider. The waiter has the information because of doing his work and the fact that there is no need for access insiders to have a business or professional relationship with the issuer is taken into account.³⁸⁵ Is there a requirement of any other ‘functional link’ between the individual’s employment and the issuer of the securities to which the information relates? Under the CJA 1993, it seemed a convincing argument that there is a need for such a link, provided that the Commission in the final text of the Directive³⁸⁶ replaced the phrase ‘in the exercise of’ with the ‘by virtue’ requirement.³⁸⁷ Thus, under the CJA 1993, the waiter’s having inside information by merely exercising his employment is not sufficient to consider him an insider. The term ‘by virtue’ indicates that there should be a ‘functional link’ to the issuer. The problem is that the FSMA 2000 encompasses ‘access insiders’ who have inside information even “**through the exercise**” of their employment, profession or duties. It is, however, not clear whether the change means that there is no need for a ‘functional link’ between the “employment, profession and duties” and the access to the information. It is also not clear whether the change is directed to encompassing instances similar to that of the waiter. It could be maintained that the existence of a kind of ‘functional link’ is important to hold someone as an ‘access insider’ who is a ‘primary insider’ rather than as ‘secondary insider’. To simplify this, it does not seem reasonable to consider the waiter as a ‘primary insider’, which places him on the same level of responsibility as the director of the issuer. On the other hand, it seems fair to consider an employee of an accountancy firm who had access to inside information as a ‘primary insider’, because of his ‘functional link’

³⁸⁵ KEITH WOTHERSPOON ‘Insider Dealing: The New Law: Part V of the Criminal Justice Act 1993’ (1994) 57 *The Modern Law Review* 419. p.426.

³⁸⁶ The Insider Dealing Directive which was implemented in the UK by adopting CJA 1993.

³⁸⁷ TAKIS TRIMIDAS ‘Insider Trading: European Harmonization and National Law Reform’ (1991) 40 *JCLQ* 919. p.926.

with the issuer. If there was no requirement for any ‘functional link’ the street cleaner and the director of the issuer would be on the same level of responsibility. This is seen as an unfair result.

It should be noted that the circumstances in which the waiter had inside information would make him a secondary insider, as will be explained. The difficulties arising from the ‘by virtue’ requirement indicate the sensitivity needed to draft a definition of an insider to include all potential categories.

Secondary insiders (tippees)

Jurisdiction	Related legal rules
UK	CJA 1993, Section 57(2)(b) ...a person has information from an inside source if and only if- (b) the direct or indirect source of his information is a person within paragraph (a).
UK	FSMA 2000, Section 118B(e) ...an insider is any person who has inside information- (e) which he has obtained by other means and which he knows, or could reasonably be expected to know, is inside information.
DIFC	Markets Law, DIFC Law No.12 of 2004, Section (45)(2)(e) (e) a person that learned of material information with respect to the Reporting Entity from any other person described in Article 45(2) (a), (b),(c) or (d) and knows or ought reasonably to have known that the other person is in such a relationship.
US	Case law.

There are situations in which individuals, who are not in a relationship with the issuer and do not have access to inside information by virtue of their employment or profession, nevertheless receive inside information. In some circumstances they either know it is inside information or it that it comes from an inside source, or they know both. This category is called ‘secondary insiders’ and is distinguished from ‘primary insiders’. The distinction between the two categories (primary and secondary) is usually not found in the words of a statute. However, statutes usually differentiate between the two groups for a legal reason: to prove the possession of inside information. Primary insiders generally have access to inside information from its source as part of their relationship to the issuer. They are presumed to know the materiality of the information and should know the consequences of dealing on the basis of it. Thus, it is appropriate for the law not to introduce a strict requirement in

regard to ‘primary insiders’, such as to prove their possession of the particular inside information or to prove their knowledge of the information. As explained earlier³⁸⁸ the more prerequisites there are for the law to prove knowledge and intention the more it will be difficult to prove cases of insider dealing. It therefore seems to be fair if ‘primary insiders’ are assumed to have access to inside information.³⁸⁹ On the other hand, ‘secondary insiders’ usually have no relationship to the source of information, and therefore it is not fair to assume they have knowledge of it.

In the US, the challenge for the law had been to find a ground for attaching liability to individuals who possess inside information and can exploit it in a similar manner to primary insiders. One method by which the law attempted to extend liability to such circumstances was necessitating a relationship between the source of the information and the tippee. Inside information must be obtained by virtue of this relationship. This has been the trend in the US, where extending fiduciary relationship in the light of the ‘disclose or abstain rule’ was a method of holding tippees liable. To achieve this, the notion of fiduciary relationship was extended beyond the ordinary concept. In the US, the function of including ‘secondary insiders’ used to be fulfilled by the ‘disclose or abstain rule’. This was so in the case of *In re Cady Roberts & Co.*³⁹⁰ In this case, the secondary insider was a broker who was given inside information by a partner. However, the current position in the US is that ‘secondary insiders’ are held liable because their dealing while in possession of material non-public information is “misappropriation”, as was the case in *United States v. O’Hagan*.³⁹¹ (For an in-depth explanation see heading: ‘Misappropriation’ theory. p.147.)

In the UK, while the definitions of ‘primary insiders’ were similar under both the CJA 1993 and the FSMA 2000, the definitions of ‘secondary insiders’ were different. Under the CJA 1993, provided primary insiders are directors, employees or shareholders of the issuer, in addition to those who access inside information by virtue of their employment, office or profession, a secondary insider is someone who has inside information directly or indirectly from a primary insider.

³⁸⁸ See above heading: Criminal Justice Act 1993 Part V.

³⁸⁹ EDDY WYMEERSCH ‘The Insider Trading Prohibition in the EC Member States: A Comparative Overview’ in KLAUS HOPT AND EDDY WYMEERSCH (eds.) *European Insider Dealing* (London: Butterworths, 1991). p.69-70.

³⁹⁰ *In re Cady Roberts & Co.* 40 SEC 907 (1961).

³⁹¹ *UNITED STATES v. O’Hagan*, 92 F.3d 612 (8th Cir. 1996). In the Supreme Court *United States v. O’Hagan*, 117 S.Ct. 2199, 2211 (1997).

This definition of secondary insiders under the CJA 1993 is mostly based on a ‘person connection’ criterion. This means that a person’s possession of inside information is not sufficient to consider him an insider.³⁹² Under the CJA 1993 there is no requirement of a relationship between the tippee and the insider source. However, the CJA 1993 adopted a restrictive determination of ‘secondary insiders’. This approach was adopted under considerations of fairness, since it seemed necessary to restrict the scope of people who could be liable to criminal sanctions. Provided that there is no requirement of a relationship between the tippee and the inside source; there must be a requirement of knowledge of the source of information. This restrictive approach is clear in Section 57(1) of the CJA 1993, which states that “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, inside information, and (b) he has it, and knows that he has it, from an inside source*” (my italics). Thus, the CJA 1993 requires that the secondary insider must know that he has inside information, and that he has it from an inside source. In fact, these prerequisites were thought to be almost impossible to prove, and consequently the effectiveness of the CJA 1993 was questioned.³⁹³

A difficulty arose in regard to the following question: what is the precise knowledge of the inside source required to hold the tippee liable according to the CJA 1993? The answer is that the act in its spirit is ambiguous in this area. On one hand, the CJA 1993 attempted to capture a wide scope of secondary insiders by requiring a wide criterion. That is the “direct or indirect” source of the secondary insider’s source of information is a primary insider. This results in the proposition that even if the information was passed indirectly (from primary insider to tippee to sub-tippee) the last sub-tippee is liable, since his ‘indirect’ source of information is a primary insider. This also suggests that the CJA 1993 catches instances in which the information is passed through electronic means to conceal the identity of the informant. On the contrary, the CJA 1993 requiring the secondary insider to know that he has the information from an inside source restricts the scope of insiders. This problem was faced under the Companies Securities (Insider Dealing) Act 1985, where Lord Lowry interpreted the word ‘knowingly’ in Section 1(3)(a) and 2(1)(b) as meaning that in order to hold a tippee liable he must know the identity of his informant.³⁹⁴ However, this

³⁹² Z. SU AND M. A. BERKAHN ‘The Definition of “Insider” in Section 3 of the Securities Markets Act 1988: A Review and Comparison with other Jurisdictions’ School of Accountancy, Massey University, New Zealand, Discussion Paper Series 218, November 2003.

³⁹³ See heading: Criminal Justice Act 1993 Part V.

³⁹⁴ [1989] AC 971, at 993.

comment has been criticized as over-restrictive. It does not seem to be just that the law requires a secondary insider to know the identity of his informant. Such a requirement is over-restrictive and unnecessary.³⁹⁵ It also appears that Lord Lowry's comments cannot be correct under the CJA 1993, because such an interpretation confines the scope of the legislation. The CJA 1993 aims to include even sub-tippees whose *indirect* source of information is a primary insider.³⁹⁶ To explain this, it seems unnecessary to require tippees' knowledge of the identity of the insider source, since this is a perverse reading of the ambit of the act which attempts to include sub-tippees. It would be difficult to require that even sub-tippees know the identity of the inside source. This is also supported by the government's consultation paper, stating that "It is not proposed that the secondary insider need know exactly which primary insider was the source, but instead that he should know only that it came from a primary insider".³⁹⁷

Secondary insiders' knowledge of the inside information and the source of information is a component of the intention required by the CJA 1993. It has been suggested that the act would have been better depending on tippees' knowledge of the specific quality of information received, rather than on their knowledge of the source of information.³⁹⁸ Nevertheless, requiring the knowledge of the specific quality of inside information may also be interpreted as a restrictive reading of the provision. It seems, therefore, that the best solution would be to introduce an objective criterion. To give an example, a requirement should be included that the secondary insider (the tippee) knows, or ought reasonably to have known, the position of the inside source. An advantage of this will be fewer impediments to proving the secondary insider's knowledge.

The FSMA 2000 under Section 118B defines secondary insiders for the purpose of this act. It introduces a general definition of secondary insiders under (e). This definition is consistent with the Market Abuse Directive in terms of differentiating between primary and secondary insiders. A secondary insider would only be considered to be so if he knows, or

³⁹⁵ TAKIS TRIMIDAS 'The House of Lords Rules on Insider Trading' 52 *The Modern Law Review* 851. p.855.

³⁹⁶ KEITH WOTHERSPOON 'Insider Dealing: The New Law: Part V of the Criminal Justice Act 1993' (1994) 57 *The Modern Law Review* 419. p.426.

³⁹⁷ DEPARTMENT OF TRADE AND INDUSTRY, *The Law on Insider Trading: A Consultative Document* (December 1989). para 2.28.

³⁹⁸ KEITH WOTHERSPOON 'Insider Dealing: The New Law: Part V of the Criminal Justice Act 1993' (1994) 57 *The Modern Law Review* 419. p.427.

ought to know, that he possesses inside information.³⁹⁹ It is also noted that this is the only distinction. Otherwise, primary and secondary insiders are all subject to the same prohibitions on dealing, disclosing and recommending.⁴⁰⁰

It is clear that the new definition of insiders under the FSMA 2000 has widened the interpretation of the term. The most important aspect is the wider scope of secondary insiders. In determining this, what is considered is the person's possession of inside information; whether he knows or could be reasonably expected to know that it is inside information. Thus, the new Section 118, by implementing the Market Abuse Directive, dispenses in most cases with the requirement of intention as an element of the offence. The requirement of intention in criminal regimes has led to profound difficulties in proving such intention, a consequence of which has been an ineffective regime. The FSMA 2000 dispenses with the strict requirements of knowledge and intention in the CJA 1993, which in Article 57(1) states that "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, inside information, and (b) he has it, and knows that he has it, from an inside source*". Under the new regime, judicial and regulatory authorities are not required to prove that the person has knowledge that he has the information from an inside source. As regards the knowledge of the status of the information, the FSMA 2000 differentiates between primary and secondary insiders. For reasons of fairness, it seems appropriate that 'primary insiders' should be at a higher level of liability than 'secondary insiders'. This is as a result of their being more likely to have a relationship with the issuer or to manipulate their position. Therefore, primary insiders are expected to observe a higher level of care not to be involved in insider dealing. The Market Abuse Directive provided a 'safe harbour' for secondary insiders, so they may be acquitted if they prove that they did not know and that they did not have to know that they were in possession of inside information.⁴⁰¹ On the other hand, Articles 2 and 3 of the Market

³⁹⁹ JANE WELCH, MATTHIAS PANNIER, EDUARDO BARRACHINO, JAN BERND AND PHILIP LEDEBOER *Comparative Implementation of EU Directives (I) – Insider Dealing and Market Abuse* (London: Corporation of London, 2005). p.25.

⁴⁰⁰ *ibid.*, p.27.

⁴⁰¹ This could be the reverse reading of the related Article, Market Abuse Directive, Art 4: "Member States shall ensure that Articles 2 and 3 also apply to any person, other than the persons referred to in those Articles, who possesses inside information while that person knows, or ought to have known, that it is inside information."

Abuse Directive do not mention this defence for primary insiders. Thus, the defence of lack of ‘actual knowledge’ is not available to primary insiders.⁴⁰²

The FSMA 2000, in Section 118B(e), implemented the definition of ‘secondary insiders’ from the above-mentioned directive. However, it appears that the wording of Section 118B(e) is advantaged in one area. It defines a secondary insider as a person who has inside information and who “...knows, or *could reasonably be expected to know*, [that it] is inside information”. From this wording it can be said that the legal criterion of determining ‘knowledge’ is that of ‘a normal or reasonable person’. Thus, “...the competent authorities should consider what a normal and reasonable person would know or should have known in the circumstances”.⁴⁰³

Secondary insiders are defined under the DIFC Markets Law, DIFC Law No.12 of 2004, Section (45)(2)(e), a person that learned of material information with respect to the Reporting Entity from any other person described in Article 45(2) (a), (b),(c) or (d) and knows or ought reasonably to have known that the other person is in such a relationship. This is an important provision, since it may have a wide scope in spite of its being drafted under one single sub-paragraph. This category in most of the recognized jurisdictions is called ‘secondary insiders’. It should be noted that the secondary insider who learns of material information must know or ought reasonably to have known of the status of the other person.

This rule is similar to the UK’s Section 118B (e) of the FSMA 2000 in one aspect: the two definitions differentiate between primary and secondary insiders in terms of the degree of knowledge required. However, they are different in terms of the type of knowledge required. Under the FSMA 2000, the knowledge required is in relation to the status of the information, whereas under the DIFC law the knowledge required is in relation to the status of the tipper.

In fact, a more careful reading of the DIFC law reveals that it requires knowledge not only of the inside source, but also of the status of the primary insider and his relationship. This is indicated by the wording of the rule: “a person that learned of material information with respect to the Reporting Entity *from any other person described in Article 45(2) (a), (b),(c) or (d)* and knows or ought reasonably to have known *that the other person is in such a*

⁴⁰² AVGOULEAS, EMILIOS *The Mechanics and Regulation of Market Abuse* (Oxford: Oxford University Press, 2005). p.253.

⁴⁰³ Market Abuse Directive, Recital 18.

relationship". Therefore, it could be said that the DIFC law requires secondary insiders to have knowledge in relation to specific facts regarding the status of their informants. This could be problematic when the regulator or the judiciary attempts to prove a case against a secondary insider.

Apparently, this is the most inconsistent legal rule in the DIFC regulation of insider dealing. This rule is unnecessarily over-restrictive. The DIFC adopted a wide definition in determining insiders, and this seems to be the general approach in Article 45. Nevertheless, the scope of secondary insiders is restricted under Article 45(2) (e) by two means. The first restrictive means is that it states "a person that learned of material information with respect to the Reporting Entity *from any other person described in Article 45(2) (a), (b),(c) or (d)...*". The rule exclusively determines those from whom a secondary insider learns of the information. The rule does not expressly indicate the way in which information is learned "directly or indirectly". Thus, the wording of the rule proposes that those who indirectly learn of the information are not liable. It appears that only those who learned of material information *directly* from primary insiders are liable to be secondary insiders. In other words, sub-tippees could not be held liable under this rule. If (A) is a director who passed the information to (B) and the latter passed the information to (C), suppose that (B) is not described in Article 45(2) (a), (b),(c) or (d). In this case, (C) would not be regarded as a secondary insider. This is because the wording of the rule suggests that he would only be liable if he learned of the information from the determined categories. The second restrictive means is that the rule requires the secondary insider to know the relationship of the primary insider to the issuer. It states that: "knows or ought reasonably to have known that *the other person is in such a relationship*". This is compounded by the fact that primary insiders are divided into complicated categories under Article 45(2) (a), (b), (c) or (d). It seems unrealistic to require knowledge of such a complicated relationship.

This gives rise to a problem similar to that faced in the UK under the Companies Securities (Insider Dealing) Act 1985. Here, Lord Lowery interpreted the word "knowingly" in Section 1(3) (a) and 2(1) (b) to the effect that in order to hold a tippee liable he must know the identity of his informant.⁴⁰⁴ The DIFC law seems to be on the same level of restricting the scope of the 'secondary insider', since it requires knowledge of the relationship of his informant. It would have been acceptable that the secondary insider know or ought to know

⁴⁰⁴ (See above, footnotes 394 and 395).

the status of the information, rather than the status of the primary insider. The secondary insider should be required to act with care towards the information in his possession.

One advantage of the DIFC law is that it is adequate that the secondary insider ‘learned’ of material information. The use of ‘learned’ seems to be advantaged to the use of ‘obtained’, which is still used in the UK in the FSMA 2000. The term ‘obtained’ is problematic when interpreted. It may imply that the secondary insider has to make an effort to acquire the inside information. This may leave a loophole, as in the following example. (A), an employee of the company, is a primary insider. He discusses with (B), a client of the company, inside information. It can be contended that (B) did not ‘obtain’ the information, because he made no effort to purposely have it.

In the UK, the FSMA 2000 states that a secondary insider is someone who has ‘obtained’ by other means the inside information. Interpreting the term ‘obtain’ takes us back to the Company Securities (Insider Dealing) Act 1985 in the UK. This problem was faced in the following case. A merchant bank acted as a financial adviser for the issuer. The appellant contacted the merchant bank because he was planning to acquire a controlling share in the issuer. However, the issuer agreed to another offer. An employee of the bank informed the appellant of the agreement when the information had still not been made public. The appellant dealt in the shares of the issuer making a profit. He was charged with insider dealing and prosecuted because he was a secondary insider or tippee. He dealt on the basis of inside information which he had acquired from a person connected with the company.⁴⁰⁵ The difficulty arose in relation to the way in which the appellant received the information. He did not pursue, nor did he make an effort to have, the information. The legal problem was in interpreting the term ‘obtained’. The appellant was acquitted on the basis that ‘obtained’ literally meant ‘to procure as a result of purpose and effort’. The judge’s opinion was that the accused did not make an effort to acquire the information, but rather the information was passed to him. Nevertheless, the Attorney General referred the questions of law to the Court of Appeal. The latter held that the word ‘obtained’ had a wider meaning than ‘acquired by purpose or effort’.⁴⁰⁶ The House of Lords affirmed the interpretation of the Court of Appeal. The decisions of the Court of Appeal and the House of the Lords were both based on purposive interpretation. That is to say, the objectives and not the letter of the

⁴⁰⁵ Attorney-General's Reference (No. 1 of 1988), [1989] 2 W.L.R. 195. The case was under sections 1(4)(a), 1(3) and 9(b) of the Company Securities (Insider Dealing) Act 1985. (Repealed).

⁴⁰⁶ Attorney-General's Reference (No. 1 of 1988), [1989] 2 W.L.R. 195. See TAKIS TRIMIDAS ‘Acquisition of Inside Information and Inelegant Insiders’ (1989) 10 *Company Lawyer* 156.

Act should be considered in determining the scope of the term insider. Lord Lane of the Court of Appeal reasoned the judgment that: "...if one construes the key word 'obtained' in the light of the purpose behind the Act, the construction must in our judgment be that it means no more than received".⁴⁰⁷ It is on this basis that the use of 'learned' in the DIFC law seems to be better than to the use of 'obtained', which is still used in the UK in the FSMA 2000.

* Building of rules

In conclusion, The US regulations have not introduced a definition of an insider, the UK definition is confusing and fragmented into the CJA 1993 and the FSMA 2000, and the DIFC definition unnecessarily divided insiders into complicated categories. However, it can be said that the FSMA 2000 in the UK provides the best definition of an insider in terms of clarity and dealing with the potential practical problems of the application of the law. Borrowing from the FSMA 2000, and benefiting from the advantages of the CJA 1993 and the DIFC law, a clear definition of an insider can be recommended for the UAE law.

The CJA 1993 confers insider status on traditional insiders: 'director, employee or shareholder'. The wording of the CJA 1993 seems clearer than that of the FSMA 2000 which determines traditional insiders as members of an 'administrative, management, or supervisory body'. We prefer the wording of the CJA 1993. We would recommend a draft rule to encompass traditional insiders as any 'director, employee or shareholder'.

Both the CJA 1993 and the FSMA 2000 appear to require insider's possession of the inside information 'because of' their status'. In other words, there is apparently a requirement of a link between their status and their possession of the inside information. One advantage of the DIFC regulation is that it is not necessary to show a way in which traditional insiders possess the inside information. Their merely being in a position such as director or employee, and being in possession of information, is sufficient for them to be insiders. We would recommend in a draft rule avoiding showing a way in which traditional insiders possessed the inside information. We would avoid requiring that a person has the inside information "through being" or "as a result of" his being a director.

⁴⁰⁷ [1989] 1 All E.R. 321, 325.

On the basis of the above discussion, we would recommend the following rule in which we clearly indicate traditional insiders and do not require a way in which they should possess inside information.

An insider is any natural person who has inside information who:
- is a director, employee or shareholder of an issuer of investments.⁴⁰⁸

In the US it has been a complicated problem to hold access insiders liable in the absence of a statute clearly defining them as insiders.

Considering the determination of ‘access insiders’, using sufficiently broad criteria is better than dividing insiders into complicated sub-groups, as is the case in the DIFC regulation. The DIFC law’s determination of access insiders is unnecessarily complicated and difficult to interpret. It is not necessary to determine special cases such as persons who have access to takeover information or that the person is an associate of a subsidiary company, as long as such cases are covered by the general provisions. Thus, we would recommend categorising insiders under broad criteria.

In the FSMA 2000, the addition of ‘by virtue of criminal activities’ as a category of access insiders seems to be unnecessary. As was explained, it is difficult to imagine that this addition would have an impact in confronting terrorist activities or the theft of information. In the UK, the FSMA 2000 used “**through the exercise** of their employment, profession or duties”. This is thought to indicate that there should be a link between the “employment, profession or duties” and the access to the inside information. It was explained earlier why we would prefer the use of “through the exercise”.

On the basis of these conclusions of the comparative study we would recommend the following rule to encompass “access insiders”.

An insider is any natural person who has inside information who:
- has access to the inside information through the exercise of his employment, profession or duties.

In determining the category of ‘secondary insiders’ we find that the CJA 1993 has certain deficiencies. One shortcoming is that it introduced strict requirement of intention, and knowledge of the inside information and the inside source. The FSMA 2000 determination

⁴⁰⁸ See the draft rules under the next chapter of recommendations.

of secondary insiders is superior. It does not require intention and knowledge of the inside source of information.

One gross shortcoming of the DIFC law is that it requires the secondary insider's knowledge not only of the inside source, but also of the status of the primary insider and his relationship to the issuer.

In the two previously suggested rules on 'insiders' we did not introduce any requirement of intention. There is also no requirement to show that 'primary insiders' knew the status of the inside information, since they are expected to exercise a higher level of care.

In encompassing 'secondary insiders' we prefer to show that he/she "knew or ought reasonably to have known it is inside information". This will provide a safe-harbour for secondary insiders if they did not know and they did not have to know the status of the information.

The use of 'learned' in the DIFC law seems to be superior to the use of 'obtained', which is still used in the UK in the FSMA 2000. The latter is likely to raise difficulties of interpretation.

Taking into consideration these conclusions from the comparative study, we would recommend the following draft rule.

An insider is any natural person who has inside information who:
- learned of the inside information by other means and knows or ought reasonably to have known it is inside information.

Part 2 inside information

The definition of ‘inside information’

...A definition is essential, because it determines everything else. There is no definition of inside information...

Comment – There is also more than one term used. ‘inside information’ and ‘non-public information’.

Answer – Yes, that is right, it is problematic. Taken simply, the information should be non-public and can affect the price of the issuers’ securities if disclosed. These are the two main conditions.⁴⁰⁹

Q – It is difficult to imagine how the current law could be applied. Inside information and insiders are mysterious.

A – Yes, I agree, there is no definition.⁴¹⁰

Jurisdiction	Related legal rules
UK	<p>CJA 1993, Section 56 “Inside information”, etc.</p> <p>(1) For the purposes of this section and Section 57, ‘inside information’ means information which-</p> <ul style="list-style-type: none"> (a) 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; (b) is specific or precise; (c) has not been made public; and (d) if it were made public would be likely to have a significant effect on the price of any securities. <p>(2) For the purposes of this Part, securities are ‘price-affected securities’ in relation to inside information, and inside information is ‘price-sensitive information’ in relation to securities, if and only if the information would, if made public, be likely to have a significant effect on the price of the securities.</p> <p>(3) For the purposes of this section ‘price’ includes value.</p>
UK	<p>FSMA 2000, Section 118C Inside information</p> <p>(1) This section defines ‘inside information’ for the purposes of this Part.</p> <p>(2) In relation to qualifying investments, or related investments, which are not commodity derivatives, inside information is information of a precise nature which-</p> <ul style="list-style-type: none"> (a) is not generally available, (b) relates, directly or indirectly, to one or more issuers of the qualifying investments or to one or more of the qualifying investments, and

⁴⁰⁹ MITHKAL OBAIDAT, Legal Advisor, Abu Dhabi Securities Market, *Interview Transcript*. See Appendix 6, Interview (2).

⁴¹⁰ TOJAN AL SHURIDEH, Legal Consultant, Securities and Commodities Authority *Interview Transcript*. See Appendix 6.

	<p>(c) would, if generally available, be likely to have a significant effect on the price of the qualifying investments or on the price of related investments.</p> <p>(3) In relation to qualifying investments or related investments which are commodity derivatives, inside information is information of a precise nature which-</p> <ul style="list-style-type: none"> (a) is not generally available, (b) relates, directly or indirectly, to one or more such derivatives, and (c) users of markets on which the derivatives are traded would expect to receive in accordance with any accepted market practices on those markets. <p>(4) In relation to a person charged with the execution of orders concerning any qualifying investments or related investments, inside information includes information conveyed by a client and related to the client's pending orders which-</p> <ul style="list-style-type: none"> (a) is of a precise nature, (b) is not generally available, (c) relates, directly or indirectly, to one or more issuers of qualifying investments or to one or more qualifying investments, and (d) would, if generally available, be likely to have a significant effect on the price of those qualifying investments or the price of related investments. <p>(5) Information is precise if it-</p> <ul style="list-style-type: none"> (a) 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 (b) is specific enough to enable a conclusion to be drawn as to the possible effect of those circumstances or that event on the price of qualifying investments or related investments. <p>(6) 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 decisions.</p>
DIFC	<p>Markets Law, DIFC Law No.12 of 2004, Section (42) Insider dealing</p> <p>(1) A Reporting Entity or person in a special relationship with a Reporting Entity shall not, in the DIFC or elsewhere, deal in Investments of or relating to the Reporting Entity if the person possesses material information that:</p> <ul style="list-style-type: none"> (a) is not generally available in the market; and (b) has not been disclosed to the market in accordance with this Law or the Rules. <p>Section (45)(1)</p> <p>In this Part:</p> <p><i>'material information'</i> means:</p> <ul style="list-style-type: none"> (a) in relation to Investments, information that significantly affects, or would reasonably be expected to have a significant effect, on the market price or value of Investments; or (b) in relation to the affairs of a Reporting Entity, information relating to a change in the business, operations or capital of the Reporting Entity that would reasonably be expected to have a significant effect on the market price or value of the Investments in or related to the

	Reporting Entity.
US	Case law.

Information plays a vital role in the mechanisms of financial markets. The availability of information to all investors is very important in order to maintain an informed and efficient market. It is crucial to distinguish between two types of the information, ‘public information’ and ‘inside information’. It is logically legitimate for everyone to use public information. In contrast, inside information is the core of the problem of the regulation of insider dealing. Therefore, a clear definition of inside information is vital. Such a definition ought to draw the line between public information which can be used by everyone, and inside information which is at the centre of various regulatory requirements such as the regulation of insider dealing and timely disclosure.

‘Inside information’ is a concept which is as crucial as that of the ‘insider’. The flow of a substantial amount of information through the internal structure of a company, as well as in the market, is a normal event. For the purpose of regulating insider dealing, ‘inside information’ should be distinguished from ordinary information. This objective is approached by different methods in various jurisdictions. As has been indicated, the US approach in regulating insider dealing is one of the SEC’s and courts’ expansive definition of Rule 10b(5). The determination of ‘insider’ and ‘inside information’ has been reached through jurisprudential theories directed at constructing a basis for liability. In the UK, there are two definitions of inside information under Section 56 of the CJA 1993⁴¹¹ and Section 118(C) of the FSMA 2000.⁴¹² In the DIFC, the definition of inside information may not attract much discussion because it is more direct and simple than that of the insider. In brief, there have been various requirements in different jurisdictions for a piece of information to be considered as ‘inside information’ or ‘material non-public information’. Nevertheless, for the purposes of explanation these requirements can be divided into two main elements of inside information: ‘non-public’ and ‘material’.

The definition of inside information under the FSMA 2000 is similar to the Market Abuse Directive’s definition. A general ‘primary’ definition is introduced in addition to two

⁴¹¹ In Implementation of the Insider Dealing Directive, Article 1(1): ‘Inside information’ shall mean information which has not been made public of a precise nature relating to one or several issuers of transferable securities or to one or several transferable securities, which, if it were made public, would be likely to have a significant effect on the price of the transferable security or securities in question.

⁴¹² Section 118(C) is a verbal implementation of Article 1(1) of the Market Abuse Directive. Therefore, it is not necessary to write the related Article in the Directive.

special ‘complementary’ definitions directed at commodity derivatives and persons charged with execution of orders. The general ‘primary’ definition will be compared to the definitions in the CJA 1993, and the US and DIFC laws. The other two special ‘complementary’ definitions will be discussed separately.

Material information

In the UK, there are two definitions of inside information, under the CJA 1993 and the FSMA 2000. Looking at Section 56(1) of the CJA 1993 and Section 118C(2) of the FSMA 2000, it is apparent that four general characteristics are required for a piece of information to be ‘inside’. For the purposes of this discussion, we think that three of the requirements can be categorized under the general requirement of the ‘materiality’ of the information. These requirements are: specific and precise⁴¹³ or precise⁴¹⁴; related; and price sensitive.

Specific or precise information

The CJA 1993 uses the two terms. They are thought to be used as a mixture of the Insider Dealing Directive’s use of the term ‘precise’⁴¹⁵ and the addition of the term ‘specific’ by the UK government. It appears that the term ‘specific’ was introduced because the UK government was aware that the use of the term ‘precise’ alone would be interpreted as only ‘narrow, exact and definitive’.⁴¹⁶

It is important to observe that the two terms were not meant to be synonymous. Interpretation could be derived from examples drawn from the Standing Committee. The Economic Secretary provided the example of someone who knew that a takeover would occur; this kind of information is specific inside information, while details of the offer price would be considered precise information.⁴¹⁷ The Economic Secretary also indicated that if a chairman had said, ‘Our results will be much better than the market expects or knows’, this would not be considered precise information because the exact results of the company had not been disclosed. However, the Minister considered the information as specific because the chairman would have disclosed something about the company’s results.⁴¹⁸

⁴¹³ Under the CJA 1993.

⁴¹⁴ Under the FSMA 2000.

⁴¹⁵ The Insider Dealing Directive, Article 1(1) “Inside Information shall mean information which has not been made public of a *precise* nature...”.

⁴¹⁶ KEITH WOTHERSPOON ‘Insider Dealing: The New Law: Part V of the Criminal Justice Act 1993’ (1994) 57 *The Modern Law Review* 419. p.421.

⁴¹⁷ House of Commons Standing Committee B, Fifth Sitting, 10 June 1993, cols 173-175.

⁴¹⁸ House of Commons Standing Committee B, Fifth Sitting, 10 June 1993, cols 174.

It is noticeable that Section 118C (5) of the FSMA 2000 replaced the term ‘specific or precise’, used in the CJA 1993, with the term ‘precise’. The question arises as to whether there is a distinction between the two expressions. If the term ‘precise’ is considered to have a narrower scope than ‘specific’, does omitting ‘or specific’ narrow the definition employed in the CJA 1993? Arguably, information under the FSMA 2000 must be both ‘precise’ and ‘specific’. However, Section 118C (5) of the FSMA 2000 defines ‘precise information’ as that which: (a) 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 (b) is specific enough to enable a conclusion to be drawn as to the possible effect of those circumstances or that event on the price of qualifying investments or related investments. It is clear that under the FSMA 2000’s ‘precise’ includes even information indicates “circumstances [which] may reasonably be expected to come”. It is, therefore, unlikely that the term ‘precise’ has a narrow interpretation. Returning to the example of the Economic Secretary,⁴¹⁹ if a chairman had said ‘Our results will be much better than the market expects or knows’. It is clear that the chairman’s statement under Section 118C (5) of the FSMA 2000 indicates circumstances reasonably expected to come. It is therefore ‘precise’ information.

The opinion of the FSA is important in clarifying the meaning of ‘precise information’. The FSA thinks that there may be information which is not ‘wholly specific or precise’, but is still ‘relevant’.⁴²⁰ In the case of *Arif Mohammed v. FSA*,⁴²¹ the Financial Services and Markets Tribunal held that a piece of information is ‘precise’ even if there is no certainty but only a serious possibility that the event referred to will occur. Mr Arif Mohammed was a former PricewaterhouseCoopers (PwC) audit manager. Delta plc was an audit client of PwC. Mr Arif Mohammed, as a member of the audit team, became aware of confidential information relating to Delta plc. The confidential information was that Delta intended to sell its electrical division. He was told that the information was confidential and not to be discussed or disclosed. While in possession of this confidential information, he purchased shares in Delta. Following the announcement, Mr Arif Mohammed sold his shares making a profit. The FSA found that he breached the original Section 118 of the FSMA 2000, since his behaviour amounted to ‘misuse of information’. Mr Arif Mohammed appealed to the

⁴¹⁹ House of Commons Standing Committee B, Fifth Sitting, 10 June 1993, cols 173-175.

⁴²⁰ FSA, Consultation Paper No. 59, July 2000. *Market Abuse: A Draft Code of Market Conduct*. para 6.22.

⁴²¹ Financial Services and Markets Tribunal, *Arif Mohammed and the FSA*, March 2005.

Financial Services and Markets Tribunal. He raised the point that:

A primary plank in the Applicant's argument is that the information in his possession was not "specific and precise". He accepts that he was aware of a possible sale, but says that he did not know until it happened that it would or was likely to happen. He argues that it was the details relating to the disposal that were relevant, cash to be received, terms and conditions, profit to be received by the vendor which would have determined whether the transaction would be favourable to Delta, and therefore result in a rise in the share price.⁴²²

However, the Financial Services and Markets Tribunal responded that:

However as the Tribunal has found, at the end of November when he purchased the shares, though he did not have the details of the proposed deal, the Applicant was fully aware that the sale process was ongoing. The Tribunal is satisfied that this information was in itself specific and precise. The Applicant knew what other market users could only guess at, namely that Delta was in fact in the train of selling its electrical division, even if there was always the possibility that the sale might not go ahead, and uncertainty as to how, if it did, it would affect the share price.⁴²³

Requiring the specific or precise nature of information is aimed at excluding rumours and untargeted information from the purposes of the Act. Thus, rumour or speculative gossip should not be regarded as inside information.⁴²⁴ While this appears to be a matter of logic, a more problematic issue concerns inferences and conclusions which could be drawn from knowledge of inside information. In the Australian case of *Ryan v. Triguboff*⁴²⁵ it was held that inside information must have 'an existence of its own quite apart from any process of deduction' and 'not merely that it [the information] is precisely definable but that its entire content can be precisely and unequivocally expressed and discerned'.⁴²⁶ The approach in *Ryan* is rather restrictive in regard to inferences. It does not seem that this would be the approach in the UK, especially as Section 118C(5) of the FSMA 2000 defines "precise information" as that which: (a) indicates circumstances that exist or may reasonably be expected to come into existence or an event that has occurred or may reasonably be

⁴²² Financial Services and Markets Tribunal, *Arif Mohammed and the FSA*, March 2005. p.16.

⁴²³ Financial Services and Markets Tribunal, *Arif Mohammed and the FSA*, March 2005. p.16.

⁴²⁴ JANNE HAYRYNEN 'The Precise Definition of Inside Information' (2008) 23 *Journal of International Banking Law and Regulation* 64. p.66.

⁴²⁵ *Ryan v. Triguboff* [1976] 1 NSWLR 588.

⁴²⁶ *ibid.*, p.596, per Lee, J.

expected to occur. It is therefore, reasonable to say that it is no longer required that the entire content of the information should be discernable.

Under both the US and DIFC laws there is no particular requirement that the information should be specific or precise. However, we would argue that the general requirement for the information to be ‘material’ is sufficient. Such an argument can be supported by the definition provided for ‘precise information’ by the FSMA 2000 in the UK. Section 118C (5) of the FSMA 2000 defines “precise information” as that which: (b) is specific enough to enable a conclusion to be drawn as to the possible effect ... on the price of qualifying investments. This is similar to the requirement that the information should be ‘material’. It is clear that this definition of ‘precise’ is equivalent to the requirement that the information is ‘material’.

The requirement for information to be ‘specific or precise’ is dealt with differently in the US. It appears that the specificity of information is part of the general requirement for information to be ‘material’. The source of this requirement in the US is case law. *TSC Industries Inc. v. Northway Inc.*, is considered a precedent in determining ‘material information’. In this case, the US Supreme Court decided that the determination of materiality requires delicate assessments of the inferences a reasonable investor (in the facts of the case a reasonable ‘shareholder’) would draw from a given set of facts and the significance of those inferences to him.⁴²⁷ This means that inside information includes those inferences which a reasonable investor would reach from facts in his possession. The issue of materiality, according to this judgment, is a question of fact and it is judged by an objective criterion which is a reasonable investor. Thus, in *SEC v. Texas Gulf Sulphur* the US Second Circuit Court of Appeals decided that this approach does not prohibit an insider from trading on the basis of the conclusions he has reached with the benefit of greater powers of analysis or a superior experience of financial issues.⁴²⁸

Related information

One of the issues in determining inside information is that of distinguishing it from general information and knowledge which is not within the purpose of the regulation. The requirement of particularity lies in the relation of information to issuers, securities and

⁴²⁷ *TSC Industries Inc v. Northway Inc* (1976) 426 US 438, at 449.

⁴²⁸ *SEC v. Texas Gulf Sulphur Co.*, 401 F.2d 833 (2d Cir. 1968), at 848-849.

sectors as a whole. In the UK, both the CJA 1993 and the FSMA 2000 require information to be related to particular securities or to a particular issuer of securities.

It is argued that the CJA 1993 attempted to encompass in the definition information which relates to a particular sector. That is to say, information is still inside if it relates to a particular sector 'issuers of securities', even if it does not relate to a specific issuer or security.⁴²⁹ An example of this is a proposed new tax on a particular sector which may have effects on all the companies in the sector. However, this seems to be drawing an ambitious target for the regulation of insider dealing. It is not possible to regulate dealing on the basis of information relating to a whole sector. To provide an example, because of his profession a banker knows that the banking sector will report significant losses and he sells the securities he owns in a related bank. In this example, the information relates to a particular sector, 'issuers of securities', but it is difficult to imagine prohibiting people from using it. This is supported by the fact that there has been no case brought against anyone who has dealt on the basis of information related to a whole sector.

Information which relates to an issuer includes that which arises from inside the issuer, such as information about financial changes in the profits of a company. However, there are circumstances in which information may arise from outside the issuer, but which still relates to it. The classic example of this is a takeover bid where the information of tender offers arises from outside the issuer, but still relates to it.⁴³⁰ In the same way, information relating to securities may be internal as well as external.

In the UK, under the CJA 1993, it is not important whether the information is from an inside source of the issuer or securities as long as it relates to it. Section 60(4) of the CJA 1993 states that:

...information shall be treated as relating to an issuer of securities which is a company not only where it is about the company but also where it may affect the company's business prospects.

This means inclusion of information which is not related to an issuer, but is likely to have a significant effect on the price of its securities. Thus, if company A introduces a new project which makes company B's project out of date, this is information about company A which

⁴²⁹ B. RIDER AND M. ASHE *Insider Crime: The New Law* (Bristol: Jordans, 1993). p.30.

⁴³⁰ B. RIDER AND M. ASHE *loc.cit.*

is also related to company B's business prospects. An insider in company A is not allowed to deal in the securities of company B.⁴³¹

Under the FSMA 2000, the regulation covers information relating 'directly or indirectly' to the issuer or the securities. The FSMA 2000 in covering 'information relating indirectly' fulfils the same function as Section 60(4) of the CJA 1993.

In the DIFC Markets Law, DIFC Law No.12 of 2004, Section (45) (1) covers material information: (a) in relation to Investments; and (b) in relation to the affairs of a reporting entity. Seemingly, one shortcoming is that the law did not explicitly include information which 'indirectly' relates to the securities or the issuer. It can be said that a thorough reading of the provisions indicates that there should have been an explicit covering of indirectly related information. Under the definition of the insider it was indicated that insiders who possess inside information relating to a takeover are encompassed. In addition, the definition covers insiders who possess inside information because of an indirect business or professional relationship. In fact, information in these circumstances can be originated outside the issuer, but can, nevertheless, be related to it. To give an example, (A) is a lawyer who advises company (B) concerning entering a major contract. The contract would affect the business of company (C). (A) dealt in the securities of (C) while in possession of the information. In this example, although (A) is considered to be an insider, depending on the language of the law, he may defend his liability on the basis that the law does not expressly encompass information which indirectly relates to the issuer.

The above problem was confronted in the US using a different method. The problem of the source of information arose when there was adoption of misappropriation theory as a ground for liability. In *Chiarella v. United States*⁴³², the information about tender offers arose from outside the issuer, but it was related to it. Although the Supreme Court declined the conviction, the case triggered the emergence of misappropriation theory. The adoption of the theory was essentially directed at prohibiting 'outsiders' or 'temporary insiders' from insider dealing. However, the emergence of misappropriation theory necessitated a re-examination of the meaning of 'inside information'. The preliminary erroneous assumption was that the original 'source' of the information must also be the issuer of the securities

⁴³¹ MATTHEW WHITE 'The Implications For Securities Regulation Of New Insider Dealing Provisions In The Criminal Justice Act' (1995) 16 *Company Lawyer* 163. p.165.

⁴³² *Chiarella v. United States*, 445 U.S. 222 (1980).

subjected to insider dealing.⁴³³ Misappropriation theory premises ‘outsider’ trading liability on an obligation owed to the source of information. There is no requirement of an obligation owed to the issuer of securities. Thus, it is more accurate to say that misappropriation theory makes it irrelevant whether the securities issued by the source of information are subjected to trading.⁴³⁴

Following the Supreme Court’s rejection of the conviction in *Chiarella*, the SEC introduced Rule 14e-3 under Section 14(e). The rule prohibits dealing on the basis of information regarding tender offers, which, as a matter of fact, relates to the issuer even if it is not the source of the information. In this regard, the rule seems to be introducing a basis for regarding information which arose outside the issuer, but is related to it, as viable to be inside information.

Price sensitive information

Inside information is only relevant to regulation if it is price-sensitive. The hypothetical criterion is this: if the information were made public it would be likely to have a ‘significant effect’ on the price of the securities. While it is acknowledged that an exhaustive or precise definition of price sensitivity is far from reached, the CJA 1993 statutory definition is merely that of general terms, which in turn can be effective by providing more space for judicial discretion in order to meet practical problems. The CJA 1993 does not provide further guidance for courts, which may adopt a ‘reasonable investor’ test. However, market conditions prevailing at the time of the alleged action should be considered in the course of determining price sensitivity.⁴³⁵ The language of the FSMA 2000 is very similar to that of the CJA 1993. It states that: “...would, if generally available, be likely to have a significant effect on the price of...”. Thus, it is proper to say a ‘reasonable investor’ test would be applied under the FSMA 2000.

The hypothetical question of price sensitivity can be relatively clear if the insider dealt prior and close to the time when the information was made public, as it was in the US case of *Elkind v. Liggett & Myers Inc.*, where evidence of price sensitivity of the information was obvious and was reflected on the market price.⁴³⁶ However, the impact of the information

⁴³³ JOHN W. BAGBY ‘The Evolving Controversy over Insider Trading’ (1986) 24 *American Business Law Journal* 571. p.590.

⁴³⁴ *ibid.*, p.592.

⁴³⁵ KEITH WOTHERSPOON ‘Insider Dealing: The New Law: Part V of the Criminal Justice Act 1993’ (1994) 57 *The Modern Law Review* 419. p.424.

⁴³⁶ *Elkind v. Liggett & Myers Inc.*, 635 F 2d 156 (2d Cir 1980).

on the market price depends on various variables such as liquidity and investors' behaviour; a fact which makes it difficult to ascertain that a price change was caused by the information. Therefore, in the US case of *SEC v. Bausch and Lomb Inc.*, it was held that the drop in a company's share on disclosure of information was insufficient evidence of the price sensitivity of that information, because of the fact that a substantial decline in the same share was common in its recent history and there were other causes for the decrease in the share price.⁴³⁷

The court may take into account whatever factual matters are present in a case. The defendant's purchase of a security when he does not have a history of securities trading, or where there is a higher level of trading by a defendant with a trading history, is considered as functional circumstantial evidence.⁴³⁸

It can be said that the price sensitivity requirement is similar in the US to that in the UK. The test of 'materiality' which is adopted in the US constitutes answering a problem similar to 'price sensitivity'. Materiality is an objective question, concerning the significance of the information to a reasonable investor. As in the case of *TSC Industries, Inc. v. Northway, Inc.*,⁴³⁹ information is material where there is

... a substantial likelihood that, under all the circumstances, the omitted fact would have assumed actual significance in the deliberations of the reasonable shareholder. Put it another way, there must be a substantial likelihood that the disclosure of the omitted fact would have been viewed by the reasonable investor as having significantly altered the "total mix" of information made available.⁴⁴⁰

The leading case in the area of determining inside information, *SEC v. Texas Gulf Sulphur Co.*, adopted the same test and makes it clear that information matters in "situations which are essentially extraordinary in nature and which are reasonably certain to have a substantial effect on the market price of the security".⁴⁴¹

In the DIFC Markets Law, DIFC Law No.12 of 2004, Section (45) (1) states "...information that significantly affects, or would reasonably be expected to have a significant effect, on the market price or value of...". It is apparent that the wording of this section is very similar to that of the FSMA 2000 in the UK.

⁴³⁷ *SEC v. Bausch and Lomb Inc* 565 F 2d 8 (2d Cir 1977).

⁴³⁸ *Basic v. Levinson*, 485 U.S. 224 n.18 (1988).

⁴³⁹ *TSC Industries, Inc. v. Northway, Inc.*, 426 U.S. 438, 444-450 (1970).

⁴⁴⁰ *ibid.*, at 449.

⁴⁴¹ *SEC v. Texas Gulf Sulphur Co.*, 401 F.2d 833 (2d Cir. 1968), at 848.

The DIFC law states that "...[it] would reasonably be expected to have a significant effect...", whereas the FSMA 2000 states that "...[it] would, if generally available, be likely to have a significant effect...". It should be indicated that one advantage of the FSMA 2000 and the DIFC laws is that they cover information whose effect is foreseeable. If it was reasonably expected that the information would have a significant effect (a reasonable investor test) it does not matter if the effect did not occur in reality for one reason or another. What is important is the 'materiality' of the information.

It is worth noting that economic analysts have suggested that the microeconomic theory is to determine when information is material. In economic theory, information is material when it produces a market response and allows the investor depending on it to obtain excess returns. From this point of view, because of the economic nature of the securities market, the materiality of information is objectively decided when depending on the financial theory.⁴⁴² The courts pay little attention to the economic foundations of securities markets, and do not systematically attempt to determine the economic materiality of information. To some extent the courts are justified in not dedicating time and effort to controversial scientific findings.

Non-public information

One of the important characteristics of inside information is that it has not been made public. It is logical that public information can be used by everyone. The core of the problem of insider dealing is the existence of non-public information which is not in the public domain, and hence insiders to the information could use it to gain an advantage over others. Disseminating non-public information into the public domain is the function of the disclosure system. Thus, it can be said that disclosure is the main device which distinguishes between non-public and public information. Considering information non-public for the purpose of prohibiting insider dealing is primarily dependent on the disclosure rules. In modern marketplace regulation the two issues are harmonized. If the information was disclosed according to the marketplace regulation, it should be acknowledged by the same regulation that the disclosed information is public and not relevant for the purposes of insider dealing regulation. The applicable disclosure rules and

⁴⁴² ALAN A. STEPHENS AND CARYN L. BECK-DUDLEY 'The Efficient Market Theory and Insider Trading: Are We Headed in the Right Direction?' (1989) 27 *American Business Law Journal* 441. p.449.

procedures should be considered in the inquiry of information being made public. This means that information is public if it is disclosed according to the disclosure rules.

In practice, there appears to be a difference between the information being available to the public and being available to market participants and investors. For the purposes of informing the market, it is more practical to disclose the information on the screen of the stock exchange than in the local newspaper. This practical need is recognised in developed jurisdictions, which are moving towards requiring issuers to follow a special process for the disclosure of information (for example, through a specialised news agency or the stock exchange). However, there are still jurisdictions which require only the disclosure of inside information, without requiring the disclosure to a specific news agency or to the stock exchange. In such jurisdictions it could be difficult to decide whether the disclosure made the information available for all the investors, and consequently to consider the information public. The difficulty arises because the disclosure of information to an agency not specialized in financial markets may be ineffective in covering all the investors. Therefore, it takes time for the market to absorb the disclosed information, but such time can be kept to a minimum by requiring disclosure through a specialized news agency or the stock exchange. This means that information will be directly disseminated by using modern technology (for example, on the Internet or on screens in stock exchanges).

Nevertheless, even if there are specific requirements of disclosure, there is still a probability that insiders with prior knowledge of the disclosed information will be advantaged over other investors. Insiders may deal on the basis of disclosed information before the market absorbs it, thereby making a profit or avoiding a loss. The language of the legislation must make it certain in terms of when the insider may deal in the related security following a disclosure being made. In the absence of certainty in the legal language, there have been attempts to interpret the terms 'not public' and 'not generally available'. The interpretation of such terms may provide contradictory conclusions, which again lead to uncertainty. For example, the term 'not public' was said to be different from 'not generally available'.

In the US, information should be non-public for the purposes of the regulation of inside dealing. The leading authority, which provides a clear determination of the concept of material non-public information, is *SEC v. Texas Gulf Sulphur*.⁴⁴³ In this case, it was

⁴⁴³ *SEC v. Texas Gulf Sulphur Co.*, 401 F.2d 833 (2d Cir. 1968).

decided that the purchase or sale of securities is not allowed if it is “on the basis of material inside information concerning the results of Texas Gulf Sulphur drilling in Timmins, Ontario, while such information remained ‘undisclosed’ to the investing public generally or to the particular sellers”.⁴⁴⁴ From here, it is clear that the essential condition of non-public information is that it is undisclosed.

In the US, the mere disclosure of the information to the public is not sufficient. There should be absorption by the market of the disclosed information. This interpretation goes even further, and argues that the fact that information has appeared on the stock exchange ticker is insufficient to consider it public and allow insiders to deal on the basis of it.⁴⁴⁵ The authority is the US case of *SEC v. Texas Gulf Sulphur*.⁴⁴⁶ In this case, an employee who took advantage of several hours prior knowledge and was able to ‘beat the news’ was held to be liable. The court’s decision was that, even following a press conference in which the information was disclosed, insiders are not allowed to deal on the basis of such information unless the market absorbs it. In this case, the court found the employee liable because the information “had not been effectively disclosed in a manner sufficient to ensure its availability to the investing public.”⁴⁴⁷

In the UK there are two definitions of inside information, under the CJA 1993 and the FSMA 2000. The CJA 1993 uses the term ‘has not been made public’, while the FSMA 2000 uses the term ‘not generally available’. The term ‘non-public’ was replaced by the term ‘not available generally’. It is essential to compare the two terms. A reasonable opinion is that the term ‘generally available’ is used as a term which is distinct from ‘made public’ to emphasise that the important factor is that of availability to market participants, rather than to the public at large.⁴⁴⁸ Whether the two terms are synonymous or not is still a question without a clear answer. This apparent confusion resulted from the use of the term ‘inside information’ in two different acts, with two different definitions for the same term. However, comparing the definitions brought under the acts, it can be said that the two terms refer to the same thing.

⁴⁴⁴ *SEC v. Texas Gulf Sulphur Co.*, 401 F.2d 833 (2d Cir. 1968), at 840.

⁴⁴⁵ MICHAEL ASHE ‘Insiders at the Starting Blocks’ (1993) 14 *Company Lawyer* 153. p.154.

⁴⁴⁶ *SEC v. Texas Gulf Sulphur Co.*, 401 F.2d 833 (2d Cir. 1968), at 840.

⁴⁴⁷ *ibid.*, at 853, n 17.

⁴⁴⁸ BARRY RIDER, KERN ALEXANDER AND LISA LINKLATER *Market Abuse and Insider Dealing* (London: Butterworths, 2002). p.85.

In the original draft of the Criminal Justice Bill, the UK government intended to leave the interpretation of the term ‘has not been made public’ to the courts. However, as a result of pressure from the Opposition and City and professional groups, the government introduced amendments in the form of guidance which was not exhaustive on when information is ‘made public’.⁴⁴⁹ Section 58(2) of the CJA 1993 states that information is regarded as made public in four circumstances.⁴⁵⁰

The definition of inside information under the FSMA 2000 is a verbal implementation of Article 1(1) of the Market Abuse Directive, but there is one insignificant difference. In the Market Abuse Directive, inside information is defined as ‘non-public’ information, while the FSMA 2000 uses the term ‘not generally available’ to define inside information. The FSMA 2000 offers no definition of the term ‘not generally available’. An explanation comes under the Code of Market Conduct,⁴⁵¹ which defines ‘generally available information’.⁴⁵²

⁴⁴⁹ House of Commons Standing Committee B, Fifth Sitting, 10 June 1993, cols 182.

⁴⁵⁰ The Criminal Justice Act 1993; Section 58:

(1) For the purposes of section 56, “made public”, in relation to information, shall be construed in accordance with the following provisions of this section; but those provisions are not exhaustive as to the meaning of that expression.

(2) Information is made public if-

- (a) it is published in accordance with the rules of a regulated market for the purpose of informing investors and their professional advisers;
- (b) it is contained in records which by virtue of any enactment are open to inspection by the public;
- (c) it can be readily acquired by those likely to deal in any securities-
 - (i) to which the information relates, or
 - (ii) of an issuer to which the information relates; or
- (d) it is derived from information which has been made public.

(3) Information may be treated as made public even though-

- (a) it can be acquired only by persons exercising diligence or expertise;
- (b) it is communicated to a section of the public and not to the public at large;
- (c) it can be acquired only by observation;
- (d) it is communicated only on payment of a fee; or
- (e) it is published only outside the United Kingdom.

⁴⁵¹ The FSA was delegated powers to adopt the Code of Market Conduct under the FSMA 2000 Section 119:

“(1) The Authority must prepare and issue a code containing such provisions as the Authority considers will give appropriate guidance to those determining whether or not behaviour amounts to market abuse...”.

⁴⁵² Code of Market Conduct, 1.2.12.

“In the opinion of the FSA, the following factors are to be taken into account in determining whether or not information is generally available, and are indications that it is (and therefore not inside information):

- (1) whether the information has been disclosed to a prescribed market through a regulatory information service or RIS or otherwise in accordance with the rules of that market;
- (2) whether the information is contained in records which are open to inspection by the public;
- (3) whether the information is otherwise generally available, including through the Internet, or some other publication (including if it is only available on payment of a fee) or is derived from information which has been made public;
- (4) whether the information can be obtained by observation by members of the public without infringing rights or obligations of privacy, property or confidentiality; and

Looking at the two definitions, it is clear that the definition of ‘generally available’ provided by the Code of Market Conduct employs many of the guidelines contained in the CJA 1993 Section 58. This, in turn, defines the term ‘made public’ for the purposes of criminal offences. In summary, there is a main condition under which the information is to be considered as ‘made public’ or ‘generally available’, which is ‘information published in accordance with the rules of a regulated market’.

Where information is published according to the requirements of a regulated market and to inform investors and their advisors, the information is regarded as ‘made public’ or ‘generally available’. The problem which arises here is when, as a matter of fairness, information should be regarded as made public. Such a problem is due to the fact that the market needs time to absorb the information, which means that insiders could take advantage of previous knowledge and deal immediately after disclosure. According to the wording of the CJA 1993 and the FSMA 2000, information enters the public domain at the time of disclosure; but there is no specific requirement that the information should be absorbed by investors, or should be reflected in the market price of securities.⁴⁵³

Some argue that such a chance for insiders “represents a contravention of the spirit, if not the letter of the law”.⁴⁵⁴ They see this as unfairly allowing insiders to escape liability and as a shortcoming of the regulation of insider dealing. However, a more rational view is that not requiring the absorption of the information by the market has the advantage of clarity. It would be difficult to decide when the market absorbs the news to allow insiders to deal.⁴⁵⁵ In fact, the market may never fully absorb the information, since the market price depends on other variables. This view is supported by an experienced practitioner.⁴⁵⁶ He thinks that if we are to consider information after disclosure and prior to market absorption as ‘inside information’, anyone who has read the information could be regarded as an insider, and could not deal until the market absorbs the information. This leads to results contrary to normal market practices, where investors wait for the disclosure and make their investment decision as soon as they receive the information. Everyone should have the right to use the

(5) the extent to which the information can be obtained by analysing or developing other information which is generally available.”

⁴⁵³ KEITH WOTHERSPOON ‘Insider Dealing: The New Law: Part V of the Criminal Justice Act 1993’ (1994) 57 *The Modern Law Review* 419. p.424.

⁴⁵⁴ MATTHEW WHITE ‘The Implications For Securities Regulation Of New Insider Dealing Provisions In The Criminal Justice Act’ (1995) 16 *Company Lawyer* 163. p.165.

⁴⁵⁵ B. RIDER AND M. ASHE *Insider Crime: The New Law* (Bristol: Jordans, 1993). p.34.

⁴⁵⁶ ALISTAIR ALCOCK ‘Inside Information’ in BARRY RIDER AND MICHAEL ASHE (eds.) *The Fiduciary, the Insider and the Conflict: a Compendium of Essays* (Dublin: Brehon Sweet & Maxwell, 1995). p.87.

disclosed information. It is therefore inappropriate to require investors not to use the disclosed information until the market absorbs it and the price of the securities moves.

The CJA 1993 Section 58, as well as the Code of Market Conduct, indicates three secondary conditions under which the information is considered to be 'made public' or 'generally available'. Information contained in records which, by virtue of any enactment, are given to inspection by the public is considered 'made public' or 'generally available'. The aim of such records is to make the information public and the public has a statutory right of access. Some of the examples drawn are those of: information recorded with the Registrar of Companies, information of a patent grant published in the Patent Office Register and information in publications such as in the Official Gazette.⁴⁵⁷

Under the CJA 1993 Section 58, information readily acquired by those likely to deal is considered to be public. When information can be readily acquired by market professionals, it is likely that this has already been used and is reflected in the market price. It is thought that this defence is offered to market professionals, such as market makers who are 'likely to deal'. On the other hand, it is not envisaged that a director could defend himself by claiming that the information had been available.⁴⁵⁸

Under the Code of Market Conduct, for the purposes of the FSMA 2000 information is 'generally available' if it is available through the Internet or some other publication (including if it is only available on payment of a fee).

Another condition which is common to both the CJA 1993 and the FSMA 2000 is that of information derived from information which has been made public. On the face of it, it seems a tautology that information is public if it is derived from public information. Nevertheless, expert analysis of public information, in the light of expert knowledge in the financial industry, may result in conclusions that have not been made public. Considering derived information (such as the results and conclusions of studies) as 'public' or 'generally available' information aims at protecting analysts, since the derivation of information from public information is part of a financial analyst's job.⁴⁵⁹ The worth of the analyst is assessed by his creative advice to market makers and clients. Therefore, it is to the benefit of financial industry to protect analysts, as long as they derive their information from information which has been made public.

⁴⁵⁷ House of Commons Standing Committee B, Fifth Sitting, 10 June 1993, cols 184.

⁴⁵⁸ ALISTAIR ALCOCK 'Inside Information' in BARRY RIDER AND MICHAEL ASHE (EDS.) *The Fiduciary, the Insider and the Conflict: a Compendium of Essays* (Dublin: Brehon Sweet & Maxwell, 1995). p.87.

⁴⁵⁹ *ibid.*, pp.87-88.

The same problem emerged in the US case of *Elkind v. Liggett & Myers Inc.* The situation is described thus:

A skilled analyst with knowledge of the company and the industry may piece seemingly inconsequential data together with public information into a mosaic which reveals material non-public information. Whenever managers and analysts meet elsewhere than in public, there is a risk that analysts will emerge with knowledge of material information which is not publicly available.⁴⁶⁰

An extreme example in which a piece of analytical information was considered to be material non-public information was the case of *US v. Carpenter*.⁴⁶¹ The inside information was that of a forthcoming column of one of the most influential columnists on the Wall Street Journal. Although the information appeared to be analytical, the Second Circuit decided that the information was material non-public information. From my point of view, it does not seem appropriate to extend the law of insider dealing to cover such extreme examples. Considering the results of studies as inside information will add unnecessary barriers to the important role of financial analysts.

The CJA 1993 stated the not exhaustive four circumstances where information is regarded as having been made public. In addition, Section 58(3) stated circumstances where information may be treated as having been made public (See footnote 450). This provision aims to give analysts and professionals guidance where uncertainty arises in regard to the status of information, which in turn discourages advice and dealings. It is also guidance for the courts to decide, according to the facts of each individual case, whether information should be treated as having been made public.⁴⁶² Looking at examples drawn at the Committee stage may reveal the purpose of this section. The Economic Secretary gave the example of an analyst who discovers price sensitive information in an obscure journal. Such information may be treated by the court as having been made public, despite the fact that it has not actually been made public.⁴⁶³ This is also the case where information is communicated to a section of the public and not to the public at large.

The Minister gave an example where information can be acquired only by observation; a factory chimney smoking at night is an indication that it was working overnight. Such

⁴⁶⁰ *Elkind v. Liggett & Myers Inc.*, 635 F 2d 156 (2d Cir 1980) at p. 165.

⁴⁶¹ *UNITED STATES v. Carpenter*, 791 F.2d 1024 (2d Cir. 1986), on appeal 484 U.S. 19 (1987).

⁴⁶² KEITH WOTHERSPOON 'Insider Dealing: The New Law: Part V of the Criminal Justice Act 1993' (1994) 57 *The Modern Law Review* 419. p.423.

⁴⁶³ House of Commons Standing Committee B, Fifth Sitting, 10 June 1993, cols 184.

information may be treated as made public.⁴⁶⁴ Information published outside the country may also be treated as having been made public. Yet, if information were published in an obscure newspaper outside the country, it is unlikely to be considered as having been made public. On the other hand, if information were published in a widely-distributed newspaper outside the country, it would be more likely to be regarded as public.⁴⁶⁵

In the DIFC Markets Law, DIFC Law No.12 of 2004, Section (42) requires the information to be ‘not generally available in the market’ and ‘not disclosed to the market’ in accordance with related regulations. There is no guidance or further explanation to these requirements. However, in spite of being simple, it appears that the wording of these requirements is direct and not expected to raise difficulties. The requirement that the information is not generally available is comparable to the requirement under the FSMA 2000 in the UK. Yet, the DIFC law adds ‘not generally available *in the market*’. It can be said that this addition makes it clear that what is important is the availability of the information in the market, rather than to the public at large. The DIFC law also requires the information to be ‘not disclosed to the market in accordance with this Law or the Rules’.⁴⁶⁶ This is the most important requirement. It acknowledges the disclosure of the information in accordance with the applicable rules as the line separating ‘public’ and ‘non-public’ information.

Market information

In brief, market information is that relating to the orders of trading, market price, volume of trading, number of traded securities or any other information which originates in the market in relation to the securities. Such information, while not related to the issuer’s financial, business or capital status, nevertheless affects the price of the securities. It appears straightforward to consider such information as inside information if the above definition of inside information is applicable. Thus, any ‘market information’ could easily be considered as inside information if it is ‘material’ and ‘non-public’.

The FSMA 2000 introduced a special definition of inside information which is related to the concept of market information. The main departure in the FSMA 2000 definition of inside information is that it is more complex in nature than that of the CJA 1993. In

⁴⁶⁴ House of Commons Standing Committee B, Fifth Sitting, 10 June 1993, col 184.

⁴⁶⁵ *ibid.*, col 183.

⁴⁶⁶ The ‘Law’ refers to DIFC, Markets Law, DIFC Law No.12 of 2004. The ‘Rules’ refers to legislation made by the DFSA and are binding in nature.

particular, there is the introduction of three definitions to complement the Market Abuse Directive. The ‘general’ definition of inside information under Section 118C (2) is applicable to all persons in possession of inside information (except persons charged with the execution of orders) and in relation to all financial instruments (except derivatives on commodities).

The second special definition of inside information under Section 118C (4) is directed towards covering intermediate or executing brokers or any other person ‘charged with the execution of orders’. It is clear that this definition aims to prohibit ‘front-running’. Front-running can be defined as a situation when a person charged with the execution of orders takes a position in the market (that is, he deals) to take advantage of upcoming orders from the customer of which he is aware.⁴⁶⁷

It seems reasonable to question whether the general definition of inside information would be sufficient to embrace cases of “persons charged with execution of orders”. In fact, the UK law verbally implemented the related special definitions of inside information in the Market Abuse Directive. However, other European countries, especially Spain and the Netherlands, were silent and did not introduce a special definition of inside information in relation to “persons charged with execution of orders”. It was expected that in these jurisdictions the general definition of inside information would be sufficient. The legal grounds would be that information regarding client orders, which is in the possession of persons charged with executing orders, would be regarded as information “relating to the securities”.⁴⁶⁸ An example would be that of a shareholder who put an order to sell a large volume of securities which may have affected the price of the security. The broker, while in possession of the information and before executing the order, dealt in the securities for his own account. Then he executed the order, the price of the security changed and he made a profit. In this case, the information in relation to the order could be considered as information related to the securities, or so-called “market information”. In fact this is the position in most of the jurisdictions.

⁴⁶⁷ Market Abuse Directive, Recital 19.

⁴⁶⁸ JANE WELCH, MATTHIAS PANNIER, EDUARDO BARRACHINO, JAN BERND AND PHILIP LEDEBOER ‘Comparative Implementation of EU Directives (I) – Insider Dealing and Market Abuse’ (2005) City Research Series, Number Eight, *The British Institute of International and Comparative Law*. p.12.

The act in the above example is called ‘front-running’. This act had been identified as a prohibited act before the adoption of the Market Abuse Directive. In *FSA v. Morgan Grenfell*, the final notice issued by the FSA imposed a fine on Morgan Grenfell and Co Ltd because of the purchase by its traders of shares that they knew a client intended to buy later the same day. The broker company failed to comply with obligations of protection of a client’s confidential information and management of conflict of interests. The FSA found that Morgan Grenfell failed to comply with the FSA Principle for Business 6 (Customer’s Interests) and 8 (Conflicts of Interest). It should be noted that this case was decided under the original Section 118 of the FSMA 2000. Morgan Grenfell used information which was not generally available, but it did not face charges of market abuse. However, this is thought to be changed after the implementation of the Market Abuse Directive. The special definition of inside information dedicated to prohibiting front-running would have a new impact. A broker’s trade on the basis of not generally available information about the trades by its client is, in a way, similar to Morgan Grenfell, and is likely to constitute insider dealing.⁴⁶⁹

Other provisions which were dedicated to front-running could be found in MAR 1.4.27 (Market Conduct Sourcebook [UK, the FSA]). This rule prohibits front-running of customer orders. This type of action was not dealt with in former insider dealing provisions. One related provision is contained in paragraphs 2 to 4 of Schedule 1 of the CJA 1993, which was dedicated to the special defence of ‘market information’ available for market makers. Under this section a market maker has a defence if he shows that it was reasonable for him in his position to deal on the basis of market information, such as negotiations for the sale of a large block of shares.⁴⁷⁰ It appears that even this defence would not have covered front-running by all those in the market, since it is not reasonable for a broker in such a position and capacity to use such a defence. In other words, a reverse reading of this provision indicates that front-running and the misuse of market information is covered by the CJA 1993.

⁴⁶⁹ ANDREW HENDERSON ‘Financial Services Authority v. Morgan Grenfell in the Light of the Market Abuse Directive’ (2004) 19 *Journal of International Banking Law and Regulation* 310. p.312.

⁴⁷⁰ KEITH WOTHERSPOON ‘Insider Dealing: The New Law: Part V of the Criminal Justice Act 1993’ (1994) 57 *The Modern Law Review* 419. p.431.

* Building of rules

In the US, the definition of inside information has not been as difficult as that of the insider. In the DIFC, although the definition of inside information is simple, it is straightforward and clearer than the definition of the insider. Only in the UK have the CJA 1993 and the FSMA 2000 attempted to thoroughly state the necessary characteristics of inside information. It can be said that both the CJA 1993 and FSMA 2000 in the UK provide the best definitions of inside information. The DIFC law is also simple and clear. Borrowing from the CJA 1993 and FSMA 2000, and benefiting from the DIFC law, a clear definition of inside information can be recommended for the UAE law.

In defining inside information, we would maintain that there are two main requirements of a piece of information if it is to be distinguished as inside information. These are that it is material and non-public. Therefore, we would recommend the following rule:

Inside information is information which is: 1- material, 2- non-public.

One advantage of both the CJA 1993 and FSMA 2000 in the UK law is that they explicitly state and provide definitions of ‘material’: that the information should be precise, related and price-sensitive.

We prefer the FSMA 2000 definition of precise information. We would prefer defining ‘precise’ as stating that “precise information is that which indicates an event that has occurred or may reasonably be expected to occur”.

There should also be a requirement that the information ‘relates directly or indirectly to the investments or to the issuer of the investments’. This function was clearly fulfilled by the CJA 1993 and the FSMA 2000.

We would argue that it is unattainable to cover information which relates to a whole industry. Such information can be general, and it is not possible to prohibit people from using general information.

We prefer using a ‘reasonable investor test’ to decide price sensitivity. This can be achieved by the use of the following wording “...would, if generally available, be likely to have a significant effect on...”.

Consideration should be given to the circumstances in which market information is inside information. In such cases, anyone who has access to the inside information is an insider, including those who are charged with the execution of the order. However, we would argue that the general definition of inside information should encompass market information. We think that such information is encompassed by the general definition, because it “relates, directly or indirectly to the investments”.

On the basis of the above-mentioned conclusions, we would recommend the following rule:

Information is material if it:

- is precise information which indicates an event or circumstance that has occurred or may reasonably have been expected to occur;
- relates, directly or indirectly, to the investments or to the issuer of the investments;
- would, if generally available, be likely to have a significant effect on the market price or the value of the related investments.

The main test in distinguishing public from non-public information should be the disclosure of the information in accordance with the disclosure rules. It is essential to recognise the link between the regulation of insider dealing and timely disclosure. Thus, we would recommend the following rule:

Information is non-public if it is:

- not generally available;
- has not been disclosed in accordance with any laws and regulations applicable in the country.

There are circumstances in which information should be considered public. Only under the CJA 1993 and the FSMA 2000, were such circumstances clearly determined. Information should be considered public if it is disclosed in accordance with the laws and regulations of markets, if the information is otherwise generally available, if it is derived by analysing or developing other information which is public and if the information can be obtained by observation.

On this basis we would recommend the following rule:

Information shall be considered public if:

- it is disclosed in accordance with any laws and regulations applicable in the country;
- it is otherwise generally available;
- it is derived by analysing or developing other information which is public.
- it can be obtained by observation.

Part 3 related concepts

Prohibited activities

There has to be clarification of the acts which are not prohibited. A precise perception of the act should be introduced. There has to be a clear formulation of the prohibited act.⁴⁷¹

The activities which may amount to insider dealing should be appropriately defined in legislation. The act is still called insider ‘dealing’, but in fact it is not only the activity of ‘dealing’ which is prohibited. A description of prohibited activities must be broad enough to avoid loopholes allowing insiders to exploit inside information. However, it must not be too broad to intervene in legitimate trading activities.

The classic notion is that insider dealing is the buying or selling of securities by an insider while in possession of inside information. However, the insider can pass the inside information to another person to allow him to deal in the securities or even to advise a third one. Thus, it is sound that such activity of improper disclosure must be prohibited, and loopholes which can be exploited must not be left. An insider may also, based on inside information, encourage another to deal in securities without disclosing the information to him. It is, therefore, also rational to prohibit other activities based on inside information, such as encouraging or procuring another to deal.

In the US, it is argued that defining insider dealing would result in leaving loopholes, where insiders may engage in activities not covered by the statutory definition. However, we can say that while the definition of insider was the main difficulty in the US law, determining the prohibited activities has not raised any difficulties. Encompassing the act of ‘dealing’ does not raise any difficulties. The US law also encompasses the activities of ‘passing the information to other’ and ‘recommending on the basis of the information’. This is clear in the case of *SEC v. Texas Gulf Sulphur*. The court held Darke and Coates liable because they “had divulged such information to others for use in purchasing TGS stock or calls or recommended its purchase while the information was undisclosed to the public or to the sellers”.⁴⁷²

⁴⁷¹ HABIB ALMULLA, Former MP (Member of the Federal National Council) and Former Chairman of the Dubai Financial Services Authority, *Interview Transcript*. See Appendix 6, Interview (4).

⁴⁷² *SEC v. Texas Gulf Sulphur Co.*, 401 F.2d 833 (2d Cir. 1968), at 841.

In the UK, the CJA 1993 embraces three types of prohibited activities. These are dealing, encouragement and disclosure.⁴⁷³ The FSMA 2000 should also have encompassed the three types of prohibited activities (dealing, encouragement and disclosure) in implementation of the Market Abuse Directive.⁴⁷⁴ However, one apparent shortcoming in the FSMA 2000 is that the activity of ‘encouragement’ is not clearly defined. The only possible solution is that such behaviour would be encompassed by sub-section 118(4) ‘misuse of information’. However, this sub-section does not clearly define the activity of encouragement. Moreover, this sub-section is subject to the introduction of a ‘sunset’ clause under Section 118(a) which means it will be abolished. This may amount to a gross shortcoming in the UK law implementation of the Market abuse Directive, which may leave a loophole for insiders to encourage or induce others to deal on the basis of inside information.

In the DIFC Markets Law, DIFC Law No.12 of 2004 encompasses the three types of prohibited activities which are dealing, providing inside information and procuring.⁴⁷⁵ In relation to the prohibited activity of passing the inside information to another person, both

⁴⁷³ The CJA 1993, 52 - The offence.

(1) An individual who has information as an insider is guilty of insider dealing if, in the circumstances mentioned in subsection (3), he deals in securities that are price-affected securities in relation to the information.

(2) An individual who has information as an insider is also guilty of insider dealing if-

(a) he encourages another person to deal in securities that are (whether or not that other knows it) price-affected securities in relation to the information, knowing or having reasonable cause to believe that the dealing would take place in the circumstances mentioned in subsection (3); or

(b) he discloses the information, otherwise than in the proper performance of the functions of his employment, office or profession, to another person.

⁴⁷⁴ Market Abuse Directive, Article 3,

Member states shall prohibit any person subject to the prohibition laid down in Article 2 from:

(a) disclosing inside information to any other person unless such disclosure is made in the normal course of the exercise of his employment, profession or duties;

(b) recommending or inducing another person, on the basis of inside information, to acquire or dispose of financial instruments to which that information relates.

⁴⁷⁵ Markets Law, DIFC Law No.12 of 2004,

Article 42. Insider dealing

(1) A Reporting Entity or person in a special relationship with a Reporting Entity shall not, in the DIFC or elsewhere, deal in Investments...

Article 43. Providing inside information

(1) A Reporting Entity or a person in a special relationship with a Reporting Entity shall not inform, other than in the necessary course of business, another person of material information that is not generally available in the market with respect to the Reporting Entity, before the material information has been disclosed to the market in accordance with this Law or the Rules.

(2) A Reporting Entity or a person in a special relationship shall not procure another person to deal in Investments if that Reporting Entity or person has knowledge of the material information that is not generally available in the market or the material information has not been disclosed to the market in accordance with this Law or the Rules.

(3) In this Article:

“*procure*” includes:

where a person induces or encourages another person by direct or indirect means.

the CJA 1993 and the FSMA 2000 uses the term “disclose”. By comparison, the DIFC law uses the term “inform” to describe the act. It is difficult to see any potential difference between the two terms.

An important point is that the disclosure should be otherwise that in the proper course of business.⁴⁷⁶ Both the CJA 1993 and the FSMA 2000 in the UK, as well as the DIFC law, provide for this exemption. Nevertheless, the clearest rule is that of the FSMA 2000, which states: “otherwise than in the proper course of the exercise of his employment, profession or duties”.

In relation to the prohibited activity of encouraging another to deal on the basis of inside information, only the CJA 1993 clearly uses the term “encourage”. Comparatively, the DIFC law uses the term “procure”, which is clarified by the law to include “where a person induces or encourages another person by direct or indirect means”. Thus, what is important is the spirit of the law in encompassing behaviour which amounts to the illegitimate use of inside information.

* Building of rules

In conclusion, apart from the shortcomings of the FSMA 2000 in prohibiting the activity of ‘encouraging’, there is no apparent difficulty in encompassing the prohibited activities in all of the compared laws. It does not seem difficult to determine the prohibited activities for the purpose of the recommended regulation of insider dealing in the UAE.

The DIFC law is superior in that it clearly determined the three types of prohibited activities. These are dealing, providing inside information and encouraging another person to deal. Also, the wording of the Market Abuse Directive can be used as guidance, since it is clear and straightforward.

Although determining the prohibited activities does not raise any apparent difficulty, the UAE regulation does not fulfil this function. On the basis of the comparative perspective, we would recommend the following rule which encompasses the three types of prohibited activities.

Any insider who has inside information shall be prohibited from:

- dealing in related investments on the basis of the inside information;
- disclosing the inside information to another person, otherwise than in the proper course of the exercise of his employment, profession or duties;
- encouraging another person, on the basis of the inside information, to deal in related investments.

⁴⁷⁶ See below heading: Exemption of normal course of business and accepted market practices.

The scope of financial instruments covered by the regulation of insider dealing

...First I want to tell you about insider dealing in the commodities market. We have two types of markets here in the DIFC; we have a commodities market and a securities market. Commodities are derivatives, so we can refer to it as the commodities derivatives market. The DIFX is seeking licensing to run a derivatives exchange where options and futures relating to financial instruments are dealt. A person, who trades on inside information in relation to commodities trading, would not be prosecuted, because there is not really an offence of insider dealing in relation to commodities trading. All commodities traders effectively deal on inside information. They have information about the market, and they have information about the supply of a particular commodity and the demand for a particular commodity. In relation to commodities trading, there is no offence of insider dealing... But there can be insider trading in derivatives on securities market.⁴⁷⁷

One essential area to be decided by the regulation is the scope of financial instruments for the purposes of the insider dealing provisions. Although there are differences between jurisdictions in this respect, what is important is clearly determining the scope of such financial instruments. Determining the financial instruments is a core point in determining the scope of the insider dealing provisions.

In the US, for the purposes of the regulation of insider dealing, it is not required that the securities be traded or listed on an exchange. In other words, an insider could be held liable even if he dealt in the shares of a public company which was not traded or listed on an exchange. In relation to the types of securities, the judicial precedents indicate that the regulation of insider dealing covers equity securities of all types. However, in relation to debt securities and options the position of the law is less clear.⁴⁷⁸

In fact, the regulation of insider dealing was limited to covering dealings in debt securities and options. The narrow scope of the regulation was the result of depending on the fiduciary duties concept to regulate insider dealing. The duty that is owed by the insiders to bondholders is a contractual duty, rather than a fiduciary duty. Therefore, it could not be said that the insider was under a duty to disclose the information to the bondholder when he dealt with him, although the insider was under no fiduciary duty to the bondholder. It is

⁴⁷⁷ ANONYMOUS 2, Dubai Financial Services Authority, *Interview Transcript*. See Appendix 6, Interviews (5), (6) and (7).

⁴⁷⁸ EDWARD F GREENE 'United States' in M. STAMP AND T. JAGGERS (EDS.) *International Insider Dealing* (Old Woking: City & Financial Publ., c2005). Para.2.2.3.

argued that the current position, by applying the “misappropriation theory”, means that insiders will also be prohibited from dealing in debt securities. Such an argument is based on the idea that misappropriation is a breach of duty to the source of information, rather than to the bondholder.⁴⁷⁹ However, it seems that this is another regulatory loophole which has resulted from not introducing clear statutory regulation of insider dealing. Without repeating the different theories and their applicability to trading in bonds, the major study in this specific point indicates that:

The example of insider trading in junk bonds highlights the deficiencies of current doctrine. The available evidence indicates that extending the ‘disclose or abstain’ rule to junk bonds would increase economic efficiency. Nonetheless, current legal doctrine does not adequately address the problem. Governing Supreme Court precedent, which relies on fiduciary duty doctrine, does not cover junk bonds at all. In addition, although the misappropriation theory may cover some instances of insider trading in junk bonds, potential gaps and ambiguities remain that undermine the efficacy of that rule.⁴⁸⁰

Another important type of financial instrument is derivatives on commodities. There has been controversy as to whether the regulation of insider dealing should cover dealings in such derivatives. In the US, the position is that insider dealing is not appropriate to commodities markets. In other words, it is thought that the insider dealing concepts are inapplicable to commodities. There is no issuer of a commodity derivative, and consequently it is not accurate to say that there is an inside source of information or that there is an insider.

In the UK, the scope of financial instruments is different under the CJA 1993 from that under the FSMA 2000. Under the CJA 1993, Section 45 Schedule 2 determined securities to which insider dealing provisions apply as the following: shares, debt securities, warrants, depositary receipts, options, futures and contracts for differences.⁴⁸¹ It is obvious that the CJA 1993 regulation of insider dealing covers shares and debt securities. The act therefore avoided a loophole which may exist in the US regulation. Thus, an insider who possesses

⁴⁷⁹ EDWARD F GREENE ‘United States’ in M. STAMP AND T. JAGGERS (EDS.) *International Insider Dealing* (Old Woking: City & Financial Publ., c2005). Para.2.2.3.

⁴⁸⁰ NOTE ‘Insider Trading in Junk Bonds’ (1992) 105 *Harvard Law Review* 1720. pp.1738-9.

⁴⁸¹ This section was adopted to implement Article 1(2) of the Insider Dealing Directive:

“ ‘transferable securities’ shall mean:

- (a) shares and debt securities, as well as securities equivalent to shares and debt securities;
- (b) contracts or rights to subscribe for, acquire or dispose of securities referred to in (a);
- (c) future contracts, options and financial futures in respect of securities referred to in (a);
- (d) index contracts in respect of securities referred in (a),

When admitted to trading on a market which is regulated and supervised by authorities recognised by public bodies, operates regularly and is accessible directly or indirectly to the public”.

inside information deals in the bonds of the related issuer rather than in its shares. The CJA 1993 also extended the scope of the regulation to cover other derivatives on securities such as options, futures, contracts and rights. The act therefore avoided a loophole in the US law which permits an insider to escape liability by dealing in options rather than in shares.

The FSMA 2000 has widened the scope of the financial instruments covered by the insider dealing provisions.⁴⁸² An in-depth explanation of the financial instruments covered does not add to the value of our discussion. Nevertheless, it is important that under the FSMA 2000, insider dealing provisions cover a wider scope of financial instruments than that under the CJA 1993 and than that under the US regulation. Most importantly, the scope of the regulation is extended to cover derivatives on commodities, interest rates, foreign exchange and other non-securities derivatives. This attitude of the Market Abuse Directive and the FSMA 2000 has been criticised for more than one reason.

The prevailing justification for the regulation of insider dealing is that it constitutes taking advantage of inside information. Allowing insider dealing contradicts the principle of maintaining a transparent and informed market and the principle of treating investors equally in terms of access to information. These justifications suggest that the regulation of insider dealing is only a preventative method to deter the exploitation and monopoly of material non-public information. It is also true that insider dealing and disclosure provisions work hand by hand to maintain an informed market. In other words, there should be a source of information which is normally “the issuer of the securities”. Insiders who possess inside information relating directly or indirectly to the issuer or the securities

⁴⁸² Financial Services and Markets Act 2000 (Prescribed Markets and Qualifying Investments) Order 2001, as amended by Regulation 10 of the Financial Services and Markets Act 2000 (Market Abuse) Regulations 2005. Article 4 determines Qualifying Investments as “...all financial instruments within the meaning given in Article 1(3) of Directive 2003/6/EC of the European Parliament and the Council of 28 January 2003 on insider dealing and market manipulation (market abuse).”

In turns Market Abuse Directive, Article 1(3) states that:

“‘Financial instrument’ shall mean:

- transferable securities as defined in Council Directive 93/22/EEC of 10 May 1993 on investment services in the securities field (1),
- units in collective investment undertakings,
- money-market instruments,
- financial-futures contracts, including equivalent cash settled instruments,
- forward interest-rate agreements,
- interest-rate, currency and equity swaps,
- options to acquire or dispose of any instrument falling into these categories, including equivalent cash-settled instruments. This category includes in particular options on currency and on interest rates,
- derivatives on commodities,
- any other instrument admitted to trading on a regulated market in a Member State or for which a request for admission to trading on such a market has been made.

should be prohibited from insider dealing. On the other hand, there is no issuer of a commodity, of foreign exchange or other non-securities financial instruments. Therefore, it cannot be said that there is an issuer who is obligated to disclose the inside information to the market. To be more specific, it is inaccurate to say that there is an “inside source of information” and there are ‘insiders’ who should be prohibited from insider dealing.⁴⁸³

It is appreciated that there is a need to confront situations in which there is misuse of confidential information. Misuse of information may occur in relation to financial matters such as official government information, central bank decisions and commercial bank business. Therefore, the Market Abuse Directive and the FSMA 2000 extended the scope of covered financial instruments to include non-securities financial instruments such as interest-rates, currency and options on currency. However, insider dealing provisions should have clearly determined objectives. Thus, extending the scope of insider dealing provisions to cover such non-securities financial instruments under the FSMA 2000 was criticised.⁴⁸⁴ It seems unrealistic to extend insider dealing provisions to cover all the actions which may constitute misuse of confidential information. Instead, the appropriate solution would be to introduce specialised laws and regulations under various industries such as public sector departments, central banks and the banking industry. It is therefore argued that it is not the function of insider dealing provisions to deter misuse of confidential information under various industries.

Another problem with extending insider dealing provisions to cover commodity markets is that the nature of information in such markets is different from that in securities markets. As was mentioned above, there is no issuer of the commodity, and therefore there is no inside source of information. Also, in commodities markets there are various sources of information which have an influence on prices. One type of information is general relevant information. To give an example, weather forecasts may contain material information which may have an effect on the price of agricultural commodities because of the effect of the weather on crops. A weather forecast predicting ocean storms leading to difficulties in oil extraction may have an effect on the price of oil contracts.⁴⁸⁵ It is obvious that it is

⁴⁸³ INTERNATIONAL SWAPS AND DERIVATIVES ASSOCIATION, *ISDA Comments on the Proposal for a Directive on Insider Dealing and Market Manipulation (Market Abuse)* (London: International Swaps and Derivatives Association, Inc., 2001). p.2.

⁴⁸⁴ *ibid.*, pp. 2-3.

⁴⁸⁵ IOSCO (2003) *Objectives and Principles of Securities Regulation*, (URL)<<http://www.iosco.org/library/pubdocs/pdf/IOSCOPD154.pdf>><http://www.iosco.org/library/pubdocs/pdf/IOSCOPD154.pdf>, accessed on 4/12/2004.

difficult to determine a specific inside source of information which could be obligated to disclose such information. The other type of information is market information which relates to the signals of trading in related derivatives. Information relating to the market price and volume of trading may affect the price of the related derivatives on commodities. The difficulty is that information relevant to derivatives on commodities is different from information relevant to securities. Therefore, to cover commodities markets, it is necessary to dedicate a special definition of inside information which is relevant to trading on commodity markets. The Market Abuse Directive introduced a special definition for inside information in relation to derivatives on commodities, which was necessary to cover such financial instruments.⁴⁸⁶ The FSMA 2000, Article 118C (3) in implementation of the Market Abuse Directive, introduced a special definition of inside information in relation to derivatives on commodities:

118 C Inside Information

...

(3) In relation to qualifying investments or related investments which are commodity derivatives, inside information is information of a precise nature which –

(a) is not generally available,

(b) relates, directly or indirectly, to one or more such derivatives, and

(c) users of markets on which the derivatives are traded would expect to receive in accordance with any accepted market practices on those markets.

Section 118C (3) defines inside information in relation to commodity derivatives as information (besides other conditions) related directly or indirectly to one or more such derivatives. The special definition under 118C (3) also replaces the requirement of price sensitivity with the requirement that:

users of markets on which commodity derivatives are traded would expect to receive in accordance with accepted market practices on those markets.

This requirement is, in turn, defined in Section 118C (7):

⁴⁸⁶ Market Abuse Directive, Article (1) states:

“...In relation to derivatives on commodities, ‘inside information’ shall mean information of a precise nature which has not been made public, relating directly or indirectly, to one or more such derivatives and which users of markets on which such derivatives are traded would expect to receive in accordance with accepted market practices on those markets”.

For the purposes of sub-section (3)(c), users of markets on which investments in commodity derivatives are traded are to be treated as expecting to receive information relating directly or indirectly to one or more such derivatives in accordance with any accepted market practices, which is-

- (a) routinely made available to the users of those markets, or
- (b) required to be disclosed in accordance with any statutory provision, market rules, or contracts or customs on the relevant underlying commodity market or commodity derivatives market.

It is notable that the special definition of inside information in relation to commodities derivatives introduced a new requirement. This is users of the markets expecting to receive the information. Insider dealing could only be perceived in relation to commodity derivatives, such as commodity future contracts, in respect to which there is information which ought to be ‘disclosed’ or ‘announced’ to the related market.⁴⁸⁷ Otherwise, it is difficult to imagine that there could be an insider who is advantaged over other investors in terms of possessing inside information. As explained, it is difficult to determine an inside source of information in relation to commodities. Thus, Section 118C (7) attempted to introduce circumstances in which inside information in relation to commodities ought to be disclosed, but the section avoided determining certain entities responsible for disclosure. It is noted that the circumstances in which information is expected to be disclosed are diverse and difficult to determine precisely. Section 118C (7) determined very wide circumstances in which the information ought to be ‘disclosed’ or ‘announced’, such as where the information is made available routinely, due to statutory provision, market rules, or contracts or customs. It is clear that these are broad circumstances. This supports the argument that it is difficult to determine the source of the information, and consequently it would be difficult to determine that there is inside information in a given case. Moreover, the special definition of inside information eliminated the requirement of price sensitivity. Price sensitivity is a main characteristic of inside information. In fact, this requirement distinguishes it from all the other information flow in business and is not the subject of insider dealing provisions. It is questionable whether it is accurate to describe ‘non price sensitive’ information as ‘inside’, since it loses an indispensable requirement.⁴⁸⁸

⁴⁸⁷ EDWARD J. SWAN ‘Market Abuse Regulation and Energy Trading’ (2004) 4 *International Energy Law and Taxation Review* 91. p.92.

⁴⁸⁸ See above heading: *Price sensitive information*.

In the DIFC, the insider dealing provisions cover a wide range of financial instruments. The term ‘investments’ is used to indicate the financial instrument covered by the provisions. ‘Investments’, under the DFSA Rulebook, indicates a wide range of financial instruments: shares, debentures, warrants, certificates, options, units, futures, rights and interests and designated investments.⁴⁸⁹ What is important for this study is the exclusion of derivatives on commodities from the scope of insider dealing regulation. This exclusion came under the DIFC Markets Law, DIFC Law No.12 of 2004, Article 42 (2):

(2) In this Article:

“*Investments*” does not include:

(a) options to acquire or dispose of;

(i) commodities of any kind; or

(ii) an option to acquire or dispose of an Investment of the kind specified by Article 42 (2).

(b) rights under a contract for the sale of a commodity under which delivery is to be made at a future date and at a price agreed on when the contract is made; or

(c) any right to or interest in anything which is specified by Article 42 (2) (a) and (b).

The DIFC law is an advocate of the position that there is no ‘inside information’ in relation to commodities. Therefore, the concept of insider dealing is not applicable to commodities markets. This view was confirmed in the interview:

Interviewer: Can we discuss Markets Law, DIFC Law No.12 of 2004, Article 42, please?

Interviewee: First I want to tell you about insider dealing in commodities markets. We have two types of market here in the DIFC. We have a commodities market and a securities market. Commodities are derivatives, so we can refer to it as the commodities derivatives market. The DIFX is seeking licensing to run a derivatives exchange, where options and futures relating to financial instruments are dealt. A person who trades on inside information in relation to commodities trading would not be prosecuted, because there is not really an offence of insider dealing in relation to commodities trading. All commodities traders affectively deal on inside information. They have information about the market, they have information about the supply of a particular commodity and the demand for a particular commodity. In relation to commodities trading, there is no offence of insider dealing. However, there is an offence of market manipulation, because entities in the market are able to manipulate the price of commodities, depending on their ability to supply more products or to reduce the supply of products.

Interviewer: In some jurisdictions attempts were made to make it an offence to deal in derivatives on commodities on the basis of inside information. Do you have any ideas about this?

Interviewee: I am not aware of this. In the US there is no crime of insider dealing in relation to commodities trading, because the basis of this kind of trading is that

⁴⁸⁹ Determined and defined under (DFSA Rulebook, General Module A2.1.1).

all traders have inside information, so they actually trade on this information on a daily basis.

In relation to securities trading, however, it is more proper that one can use inside information to manipulate the prices to a wider extent. One can also manipulate the market. So I think we have two offences: those of market manipulation and insider dealing. But there can be insider trading in derivatives on securities market.⁴⁹⁰

In the DIFC Markets Law, DIFC Law No.12 of 2004 presents a unique concept in defining the issuer. Under this law the investments covered by the regulation of insider dealing should be either of, or related to, a 'reporting entity'.

As regards the term 'reporting entity', our research indicates that this term has not been used to regulate insider dealing in either the US or European Union countries, including the UK. 'Reporting entity' is usually used in accountancy legislation and regulations to determine those entities which should prepare general purpose financial reports. A number of concepts given to define the term 'reporting entity' have arisen. These concepts include the legal entity concept, which is used in the private sector, and the accountability concept, which is used in the public sector. The most recent idea is that reporting entities are those in respect of which it is reasonable to expect the existence of users dependent on general purpose financial reports for information which will be useful to them for making and evaluating decisions about the allocation of scarce resources. Entities which are determined under this criterion as reporting entities should prepare general purpose financial reports in accordance with accounting standards.⁴⁹¹

The term 'reporting entity' is employed under Markets Law, DIFC Law No.12 of 2004 to determine entities to which the provisions of this law are applicable. Under this law, 'reporting entities' are responsible for absorbing various provisions such as listing rules, corporate governance, continuous disclosure and insider dealing. Answering the question as to the reason for using the term 'reporting entity', we find two apparent reasons. First, it is plausible to consider the wholesale nature of the DIFC, since the Dubai Financial Services Authority (DFSA) is empowered to determine which activities are financial services. The DFSA authorizes Authorized Firms and Authorized Market Institutions as the exclusive conductor of financial services. This mechanism ensures that market players are only

⁴⁹⁰ ANONYMOUS 2, Dubai Financial Services Authority, *Interview Transcript*. See Appendix 6, Interviews (5), (6) and (7).

⁴⁹¹ BALL IAN *Definition of the Reporting Entity* (Caulfield, Victoria: Australian Accounting Research Foundation, 1988) and AUSTRALIAN ACCOUNTING RESEARCH FOUNDATION *Statement of Accounting Concepts, Definition of the Reporting Entity* (January 2000).

institutional (and not retail) customers. The DIFC laws utilizes the term ‘reporting entity’ because it can be inclusive of corporations in their various stages, beginning from the time of filing a prospectus. Second, there are bodies under the DIFC which are not ordinary issuers, but are nevertheless under reporting responsibilities. Collective funds and fund managers are not ordinary issuers of securities. The term ‘reporting entity’ includes funds and fund managers. This was supported by the interviewees when asked regarding the term:

Interviewee: It is a term that is specific to our legislation.⁴⁹²

Interviewer: What is the difference between an issuer and a reporting entity?

Interviewee: The term is used here to describe a reporting entity, because we use so many terms already. So if we had used ‘issuer’ it would have been too short. ‘Reporting entities’ indicates to financial services providers that are obligated to report to the exchange or the regulator.⁴⁹³

The reporting entity includes the issuer. A jurisdiction may state that insider dealing provisions only deal with issuers. Ours is actually wider. So it captures a wider group of people, because the issuer falls within the term ‘reporting entities’.⁴⁹⁴

Interviewer: Does it include funds, because fund managers are not issuers?

Interviewee: It could be the operator of a fund. Because a fund is not issued, a fund is managed. A fund is not an issue, but you have the issue of a unit in a fund.⁴⁹⁵

In any case, the term ‘reporting entity’ has not been left to theoretical explanations. Rather, the Markets Law, DIFC Law No.12 of 2004, under Schedule (Interpretation) 3- Defined Terms, defines it.⁴⁹⁶ It appears that a reporting entity could be an issuer who has or had

⁴⁹² ANONYMOUS 2, Dubai Financial Services Authority, *Interview Transcript*. See Appendix 6, Interviews (5), (6) and (7).

⁴⁹³ ANONYMOUS 3, Dubai Financial Services Authority, *Interview Transcript*. See Appendix 6, Interviews (5), (6) and (7).

⁴⁹⁴ ANONYMOUS 1, Dubai Financial Services Authority, *Interview Transcript*. See Appendix 6, Interviews (5), (6) and (7).

⁴⁹⁵ ANONYMOUS 1, Dubai Financial Services Authority, *Interview Transcript*. See Appendix 6, Interviews (5), (6) and (7).

⁴⁹⁶ (1) Subject to (2), a person is a Reporting Entity if:

- (a) the person has or had Securities admitted to an Official List of Securities at any time;
- (b) the person has filed a prospectus with the DFSA under Article 15;
- (c) the person merges with or acquires a Reporting Entity; or
- (d) the person is declared in writing to be a Reporting Entity by the DFSA.

(2) A person is not a Reporting Entity if:

- (a) the person is a properly constituted government, a government agency, a central bank or other type of national monetary authority of a country or jurisdiction, a supranational organisation whose members are either countries, central banks or national monetary authorities, a public authority or a state investment body; or
- (b)
 - (i) the person previously had Securities admitted to an Official List of Securities;
 - (ii) the person currently has no Securities admitted to an Official List of Securities; and
 - (iii) the current holders of at least 75% of voting rights in the Reporting Entity have agreed in writing that the person is no longer a Reporting Entity; or
- (c) the DFSA so determines.

securities admitted to an official listing. It is also apparent that ‘reporting entity’ includes the person who filed a prospectus, and who may not yet be considered an issuer.

* Building of rules

From the above comparison, it seems that it is necessary to determine clearly the scope of the financial instruments and markets for the purpose of the insider dealing provisions. Each jurisdiction has a specific policy in determining the scope of regulation. Based on the ground that insider dealing is regulated to protect the market, investors and information, it can be said that this objective should determine the scope of the regulation. To protect the market and investors, a financial instrument should be admitted to trading in a market. Otherwise, it is not proper to argue that insider dealing has negative effects on the market. On this basis, the regulation can be extended to cover investment units which are not securities, but are nevertheless admitted to trading in a market. To protect information, there should be an inside source of information to maintain that there is inside information and insiders. Therefore, extending the regulation to cover derivatives on commodities was criticised because there was no inside source of information.

It is better to leave this issue to be determined by the regulator. To protect the market and investors, publicly traded financial instruments can be covered. These are any financial instrument which is admitted to trading in a market and in regards to which there is an inside source of information. Otherwise, it is not proper to argue that insider dealing has negative effects on the market. We would recommend that in drafting the regulation it seems proper to cover securities, bonds, Islamic bonds, investment units and derivatives on securities. On the other hand, it does not seem appropriate to extend the scope of the regulation to cover derivatives on commodities, interest rates, foreign exchange and other non-securities financial instruments. The attitude of the Market Abuse Directive and the FSMA 2000 in doing so is criticised.

Exemption of normal course of business and accepted market practices

All the rules are put in place not just to regulate a company individually; they are actually to facilitate business. At the end of the day, that what these rules should be all about. They should be assisting business.⁴⁹⁷

Clearly determining the concepts of the insider, inside information, and financial instruments and markets covered is vital to drawing the line between legitimate and illegitimate dealing. It remains true that jurisdictions introduce different exemptions and safe-harbours in which an act would not be prohibited in spite of its being within the theoretical definition of insider dealing. The most important point to be observed is that the regulation of insider dealing should not be a barrier to business. It is acknowledged that all the laws and regulations of financial markets should aim to advance business, not impede it. In the customs of financial markets there are accepted market practices which should not be prohibited by the regulation of insider dealing. For if such practices are prohibited, business would be impeded and there would be negative effects from the regulation. Thus, under this sub-section two essential categories of exemptions will be concentrated on: the normal course of business and accepted market practices. In fact the Market Abuse Directive is the clearest piece of legislation for determining the circumstances which should be exempted from the regulation of insider dealing. In the UK's implementation of the Market Abuse Directive, it is apparent that the FSA adopted rather vague criteria for assessing accepted market practices.⁴⁹⁸ In the US, there is also no clear determination of the exemptions. It

⁴⁹⁷ ANONYMOUS 2, Dubai Financial Services Authority, *Interview Transcript*. See Appendix 6, Interviews (5), (6) and (7).

⁴⁹⁸ In the UK, the related provisions were implemented by the Code of Market Conduct 1 Annex 2 Accepted Market Practices:

2. The FSA will take the following non-exhaustive factors into account when assessing whether to accept a particular market practice:

- (1) the level of transparency of the relevant market practice to the whole market;
- (2) the need to safeguard the operation of market forces and the proper interplay of the forces of supply and demand...
- (3) the degree to which the relevant market practice has an impact on market liquidity and efficiency;
- (4) the degree to which the relevant practice takes into account the trading mechanism of the relevant market...
- (5) the risk inherent in the relevant practice for the integrity of, directly or indirectly, related markets...
- (6) the outcome of any investigation of the relevant market practice by any competent authority...
- (7) the structural characteristics of the relevant market...

may be that such exemptions are dispersed under various regulations.⁴⁹⁹ It is therefore not helpful to discuss the related rules in any further detail.

The Market Abuse Directive required exempting the following accepted market practices from liability under the regulation of insider dealing:

- 1) market makers pursuing their legitimate business in dealing in financial instruments;
- 2) persons who dutifully execute orders on behalf of third parties,⁵⁰⁰
- 3) having access to inside information relating to another company and using it for a legitimate public takeover bid or proposing a merger; and⁵⁰¹
- 4) dealings in accordance with the rules of stabilisation of financial instruments or trading in own shares in buy-back programmes.

It is obvious that market making, brokerage, takeovers and share buy-backs are recognised as legitimate and accepted market practices.⁵⁰² Despite being within the theoretical definition of insider dealing, the prohibition of such accepted practices would impede business. It is important to note that there are special rules which are dedicated to maintaining transparency in each of these market practices. These exemptions should be read and interpreted in accordance with the related regulations. For instance, there are special regulations for takeovers which ensure the bidder's disclosure of the information.

In the DIFC Markets Law, DIFC Law No.12 of 2004, Section (48)⁵⁰³ introduces defences against liability to insider dealing. It is apparent that the exemptions to the prohibition may

⁴⁹⁹ One exemption under the US regulation is that of selective disclosure. See below heading: Selective disclosure.

⁵⁰⁰ Market Abuse Directive, Recital 18:

...the mere fact that market-makers, bodies authorised to act as counterparties, or persons authorised to execute orders on behalf of third parties with inside information confine themselves, in the first two cases, to pursuing their legitimate business of buying or selling financial instruments or, in the last case, to carrying out an order dutifully, should not in itself be deemed to constitute use of such inside information.

⁵⁰¹ Market Abuse Directive, Recital 29:

Having access to inside information relating to another company and using it in the context of a public takeover bid for the purpose of gaining control of that company or proposing a merger with that company should not in itself be deemed to constitute insider dealing.

⁵⁰² Market Abuse Directive, Recital 33:

Stabilisation of financial instruments or trading in own shares in buy-back programmes can be legitimate, in certain circumstances, for economic reasons and should not, therefore, in themselves be regarded as market abuse. Common standards should be developed to provide practical guidance.

⁵⁰³ Section 48. Defences for market manipulation, insider dealing and providing inside information

(1) A person shall not be found to have contravened Article 36 if the person establishes that the conduct or practice the person engaged in was in the performance of, and in accordance with, the price stabilisation requirements as prescribed in the Rules.

(2) A person shall not be found to have contravened Articles 42 or 43 if:

(a) the person establishes that the information was disclosed in accordance with any requirements under law;

be completely different from one jurisdiction to another. This is probably because of the special needs and priorities of each jurisdiction. To support our point, it is necessary to indicate that there should be exemptions for accepted market practices. This section exempts from the prohibition the following accepted market practices:

- 1) a conduct or practice in accordance with the price stabilisation rules;
- 2) dealing in the performance of an underwriting agreement for the investments in question;
and
- 3) dealing in the performance of the person's functions as a liquidator or receiver.

The second important category of exemptions from liability to insider dealing is conduct in the normal course of business. The Market Abuse Directive Article 2(3)⁵⁰⁴ provides a safe-harbour where the person concluded an agreement before possessing the inside information, and only the execution of the dealing occurred while he possessed the inside information. This means that a person who had concluded an agreement, irrespective of the inside information which he possessed later, would not be liable to insider dealing.

One of the most important exemptions is 'disclosure of inside information in the normal course of business'. In the DIFC Markets Law, DIFC Law No.12 of 2004, Section (48) provides a safe-harbour where "the information is given in the necessary course of business". This exemption is very important, since in the normal course of business it should be legitimate to discuss inside information with (for instance) a lawyer or an accountant. This is supported by the interviewees who said:

Interviewee: Having the inside information is not an offence and sharing the information with a colleague is not an offence. Because that sharing is undertaken by way of business in ordinary circumstances. It is acting upon that information. For example, next week we are trading a particular product.⁵⁰⁵

Interviewee: But you can only inform somebody else in the normal course of business. That is, if you have a lawyer or an accountant. You can not inform your

-
- (b) the person establishes that he reasonably believed that the material information had been disclosed to the market in accordance with this Law or the Rules;
 - (c) the information is given in the necessary course of business;
 - (d) the sole purpose of acquiring shares was to satisfy the requirement for his being qualified as a director or intending to become a director of a Reporting Entity;
 - (e) the dealing in Investments occurred in the performance of an underwriting agreement for the Investments in question; or
 - (f) the dealing in Investments occurred in the performance of its functions as a liquidator or receiver.

⁵⁰⁴ Market Abuse Directive, Article 2(3):

This Article shall not apply to transactions conducted in the discharge of an obligation that has become due to acquire or dispose of financial instruments where that obligation results from an agreement concluded before the person concerned possessed inside information.

⁵⁰⁵ ANONYMOUS 2, Dubai Financial Services Authority, *Interview Transcript*. See Appendix 6, Interviews (5), (6) and (7).

wife or mother and tell them “by the way, we going to be selling 50% of the shares in the company because the results have been really bad”. That would actually be in breach of our law. But if you call your lawyer and say “I need you to prepare a study for me because we need to perform a certain act”. This is in fact what happens in companies. Then the lawyer should keep the information confidential.⁵⁰⁶

* Building of rules

In conclusion, it seems that the special needs and priorities of each jurisdiction are different. Accordingly, the exemptions to the prohibition of insider dealing are different from one jurisdiction to another. We are of the opinion that the normal course of business and accepted market practices are different from one system to another because of the different customary rules in each system. On this basis, it is better to leave the regulator to determine this issue. We recommend that there should be two broad categories of exemptions. These are the normal course of business and accepted market practices. Informing a colleague, lawyer or accountant of inside information in the normal course of business should not be prohibited. The same is true with accepted market practices such as underwriting and share buy-backs.

⁵⁰⁶ ANONYMOUS 1, Dubai Financial Services Authority, *Interview Transcript*. See Appendix 6, Interviews (5), (6) and (7).

Chinese Walls

Q – There are legal principles which are unacknowledged in UAE jurisdiction, but such principles are central to financial regulation in developed jurisdictions, For instance, conflict of interests and Chinese walls? How can we deal with this problem?

A – There has to be a completely new law. We need a radical change in legal principles and understandings in these areas. There is a need for similar laws. These are essential principles in developed jurisdictions.⁵⁰⁷

A simple definition is:

a ‘Chinese Wall’ is the expression used to refer to an information barrier within the firm which is intended to ensure that information available to or known by certain members of the firm is not available to other members of the firm.⁵⁰⁸

The details of Chinese Wall policies and procedures are to be determined by the regulator in the light of the nature of the business of the regulated entities. However, it is acknowledged that there are minimum standards to be adopted to monitor the flow of information. Physical segregation between various departments of a firm, by locating them on different floors or in different buildings, is necessary to keep to a minimum the flow of confidential information between these departments. An example might be where a firm should be obligated to physically separate an investment department which is engaged in a takeover or an underwriting business, and a brokerage department in order to prevent the leaking of confidential information from the first to the second department. Besides the physical segregation, there should be restrictions on interdepartmental communications. There should also be restrictions on access to files, offices, computers and databases. Other procedures may include written internal policies and guidance relating to the access and use of confidential information.⁵⁰⁹

Chinese Walls were the initiatives of investment entities themselves, before becoming a statutory obligation on them. The US case of *In re Merrill Lynch*,⁵¹⁰ was the leading precedent which emphasised the use of Chinese Walls. In this case, Merrill Lynch was the

⁵⁰⁷ HABIB ALMULLA, Former MP (Member of the Federal National Council) and Former Chairman of the Dubai Financial Services Authority, *Interview Transcript*. See Appendix 6, Interview (4).

⁵⁰⁸ CHARLES HOLLANDER Q.C. AND SIMON SALZEDO *Conflicts of Interest and Chinese Walls* (London 2nd. Sweet and Maxwell, 2004). p.116.

⁵⁰⁹ CHRISTOPHER M. GORMAN ‘Are Chinese Walls the Best Solution to the Problems of Insider Trading and Conflicts of Interest in Broker-Dealers?’ (2004) 9 *Fordham Journal of Corporate and Financial Law* 475. p.485.

⁵¹⁰ *In re Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 43 S.E.C. 933 (1968). at 938.

underwriter for a public offering of bonds by the Douglas Aircraft Company. The underwriting department of Merrill Lynch learned of material non-public information constituting estimates of significant losses in the offering company. The information was divulged to the sales department, which in turn informed several clients. The result was that Merrill Lynch and its clients sold related securities and avoided a loss before the information was made public. The SEC, in its enforcement against Merrill Lynch, reached a settlement. According to the settlement, the latter adopted a Statement of Policy which prohibits disclosure of non-public information by any member of the Underwriting Division. This settlement is considered the first clear example of Chinese Walls procedures. It was later adopted by other broker-dealers to avoid SEC actions.⁵¹¹

Chinese Walls were probably first made a statutory requirement in the US under the Insider Dealing and Securities Fraud Enforcement Act of 1988. Section 15(f) states that:

Every registered broker or dealer shall establish, maintain, and enforce written policies and procedures reasonably designed, taking into consideration the nature of such broker's or dealer's business, to prevent the misuse in violation of this title or the rules and regulations thereunder of material, non-public information by such broker or dealer or any person associated with such broker or dealer.

Another example in which the US insider dealing regulations acknowledge Chinese Walls as a defence against liability is Rule 14e-3.⁵¹² According to Rule 14e-3(b), a company is not liable for insider dealing for transactions executed on its behalf if the company

...had implemented one or a combination of policies and procedures, reasonable under the circumstances, taking into consideration the nature of the person's business, to ensure that individual(s) making investment decision(s) would not violate paragraph (a) of this section...⁵¹³

Policies and procedures under this rule include Chinese Walls. It is clear that this subsection provides a safe harbour for companies against liability to insider dealing where the company implemented Chinese Walls. Therefore, under this rule, if (A) had access to inside information relating to a takeover because he is an employee in the investment department of company (B). (A) passed the information to (C), an employee in the brokerage department of the same company (B). (C) dealt in the related securities for the account of the company. The company had a safe harbour if it had implemented Chinese Walls to

⁵¹¹ HARRY ACVEA *Financial Conglomerates and Chinese Wall: Regulating Conflicts of Interests* (Oxford: Clarendon Press, 1993). p.134.

⁵¹² See above heading: SEC Rule 14e-3.

⁵¹³ SEC Rule 14e-3. Paragraph (a) relates to insider dealing on the basis of information related to takeover.

ensure that the information would not be passed between various departments. However, individuals may not benefit from this safe harbour if they have breached the internal Chinese Walls.

In the UK, the FSMA 2000 in “Commentary on Sections” states that:

Sub-section (1) enables the Authority to make rules about the disclosure and use of information held by an authorised person. These rules are commonly known as ‘Chinese walls’ rules. Chinese walls are barriers in the form of procedures, systems, management and physical separation which firms may employ in order to ensure that information obtained by one part of a firm is not communicated in inappropriate circumstances to another part of the firm (for example, where it would advantage one client at the expense of another)...

The Code of Market Conduct⁵¹⁴ in rule 1.3.5 states that:

In the opinion of the FSA, if the inside information is held behind an effective Chinese wall, or similarly effective arrangements, from the individuals who are involved in or who influence the decision to deal, that indicates that the decision to deal by an organisation is not ‘on the basis of’ inside information.

The organisation’s decision to deal being not ‘on the basis of’ inside information means that there is a safe harbour against corporate liability to insider dealing.

In the DIFC, DFSA Conduct of Business, Rule 6.3 states:

6.3.1

...

(2) Where an Authorised Firm has knowledge of a conflict or a material interest, it must manage that interest by:

(a) establishing and maintaining effective Chinese Walls to restrict the communication of that knowledge;

...

6.3.2

When a COB Rule applies to an Authorised Firm that acts with knowledge, the Authorised Firm will not be taken to act with knowledge for the purposes of that Rule as long as none of the relevant individuals involved on behalf of the Authorised Firm acts with that knowledge as a result of a Chinese Wall arrangement established under Rule 6.3.1 (2).

In addition, the Markets Law, DIFC Law No.12 of 2004, Section (49) provides a Chinese Wall defence for corporations against liability to insider dealing:

⁵¹⁴ The FSA was delegated powers to adopt the Code of Market Conduct under the FSMA 2000 Section 119: “(1) The Authority must prepare and issue a code containing such provisions as the Authority considers will give appropriate guidance to those determining whether or not behaviour amounts to market abuse...”.

49. Chinese wall arrangements

A person does not contravene Articles 42 or 43 by dealing in Investments at any time because of material information in the possession of a director, officer or employee, if:

- (a) the decision to enter into the transaction or agreement was taken on its behalf by a person or persons other than a director, officer or employee;
- (b) it had in operation at that time arrangements that could reasonably be expected to ensure that the material information was not communicated to the person or persons who made the decision and that no advice with respect to the transaction or agreement was given to that person or any of those persons by a director, officer or employee in possession of the material information; and
- (c) the information was not communicated and no such advice was given.

In an interview, a member of the DFSA, stressing the role of the company to implement Chinese Walls, confirmed that:

When we find an employee using information from the firm and we find that this person has done wrong, we apply the criminal and civil side of the law and we will disqualify him from working in the centre again. If we also found that there was a major failure by the firm in overseeing the activity of this person, we can also take action against the firm.⁵¹⁵

* Building of rules

Comparing the jurisdictions of the US, the UK and the DIFC, it appears that Chinese Walls have two functions in relation to the regulation of insider dealing. Chinese Walls are both a defence for corporations against liability to insider dealing and a practical method against the leak of information. First, the use of Chinese Walls could be a defence against companies' liability to insider dealing, as in the case of Rule 14e-3 in the US, Rule 1.3.5 in the Code of Market Conduct in the UK, and the Markets Law, DIFC Law No.12 of 2004, Section (49) in the DIFC. On this basis we would recommend the following draft rule:

A corporation contravenes the insider dealing rules if:

- 1) a natural person acts on behalf of the corporation in contravention of Article 1;
- 2) such natural person discharges managerial responsibilities; and
- 3) the corporation did not have in operation at that time any policies or procedures to ensure that such natural person would not violate Article 1. Such policies and procedures include Chinese Walls.

⁵¹⁵ ANONYMOUS 3, Dubai Financial Services Authority, *Interview Transcript*. See Appendix 6, Interviews (5), (6) and (7).

The second use of Chinese Walls is as a statutory requirement in itself. Multifunction financial companies which have various departments with conflicting interests should be obliged to implement Chinese Walls. Companies which fail to implement the required procedures for Chinese Walls should be made liable to penalties imposed by the regulator. This function of Chinese Walls is obvious in a reading of Section 15(f) of the Insider Dealing and Securities Fraud Enforcement Act of 1988 in the US, the FSMA 2000 in “Commentary on Sections” in the UK, and Rule 6.3 DFSA Conduct of Business in the DIFC. All the aforementioned rules oblige certain companies to implement Chinese Walls procedures. We would recommend that the regulator should determine details of Chinese Walls policies and procedures. Therefore, we recommend the following draft rule:

<p>The SCA shall make rules commonly known as ‘Chinese Walls’ rules. The SCA shall determine the arrangements for Chinese Walls, such as procedures, systems, management and physical separation. Firms which have departments with conflicting interests shall employ Chinese Walls in order to ensure that information obtained by one part of a firm is not communicated in inappropriate circumstances to another part of the firm.</p>

Part 4: the regulation of timely disclosure

Q – When can information be considered public?

A- When it is disclosed in accordance with disclosure rules. It depends on the rules applicable in any country. In some jurisdictions it is sufficient to disclose the information to the regulator or to the markets. In other jurisdictions it is necessary that the information reaches the public either through the media, the press or the internet.

Q – Do you think that we have shortcoming in disclosure?

A – Disclosure can be through the market, the SCA and the press. But in reality we consider disclosure to the market or the press makes the information public and so it cannot longer be considered inside information. In the market when we receive the information we convey it to the press, the investors and brokers.

Considering the timing of disclosure, it is clear when an issuer discloses the information, but it can be unclear when the issuer has known of the information. An issuer has to disclose inside information as soon as possible. However, in reality there is a period of time between the moment when the issuer knew the information and the moment it disclosed it. This period is critical to insider dealing.

Q – Are there any rules regulating selective disclosure?

A – In application any person dealing with a company signs a non-disclosure agreement. An auditor is obligated by auditing laws not to disclose any information of a client company. Insiders are not only those who work for the issuer but also who has a connection to the issuer.⁵¹⁶

Q – What if the information disclosed in accordance with the disclosure rules?

A – In this case it is public and it cannot be said that it is inside. But from the time where the information was actually present until it is properly disclosed, the information is considered non-public.

This happens as follow; an internal auditor checked the financial statements and sends the report to the board. They in turn send it to the general meeting to decide the dividends in there is profit or otherwise. In the period between the times when the auditor reached the results until the time where it was disclosed in the general meeting, the information is considered non-public.

The same is right where a company negotiates establishing a new production line. From the beginning of the negotiations until disclosing the contracting, the information is considered non-public.

This is also a problem in our jurisdiction which is disclosing information to the media before an official disclosure to the regulator. This is dangerous. The media may publish the news inaccurately and differently from a media to another. They may also write it in a certain way or take parts of the information which does not

⁵¹⁶ MITHKAL OBAIDAT, Legal Advisor, Abu Dhabi Securities Market, *Interview Transcript*. See Appendix 6, Interview (2).

reflect the real information. On contrary when the information is disclosed to the SCA it will disclose it precisely to the public.

Q – There is a loophole in regulation in this area. In other jurisdictions there are rules applied which regulates how the issuer should deal with the media. What do you think?

A - Probably yes. The problem is disclosing the information to the media. Sometimes there is contradiction in the news or even confusion. The next day the company approves or disapproves the news. From the time such news is published until the company officially is requested to comment, there would have been dealings on the basis of such news.

...Some influents can deal and delay disclosure two or three days...⁵¹⁷

The relationship between the regulation of insider dealing and timely disclosure

When studying insider dealing regulation, the concept of disclosure constantly surfaces as an important correlate. It is therefore hardly surprising that writers study disclosure whenever they study insider dealing regulation. It is still important to study the relationship between the rules directed to insider dealing regulation and those directed to disclosure. Reviewing the legislative history of insider dealing regulation in the US and the UK reveals that there have been confusions as to whether a rule aims to regulate insider dealing, disclosure or both. Studying modern securities regulation in the US and the UK also shows the degree to which insider dealing could be discouraged through disclosure rules.

This part of the chapter aims at sustaining the argument that insider dealing is largely a financial market problem, the best solution of which is regulation. It is based on the account that for a transparent and informed financial market, regulation has to be improved to assure that. This part establishes that insider dealing regulation and disclosure rules have a common object of maintaining an informed market.

Timely disclosure rules are designed to maintain a flow of inside information into the market to help maintain an informed and transparent market where the prices of securities optimally reflect the disclosed information. Disclosure rules are intended to facilitate business. Therefore, they have to be clearly and descriptively drafted, and underlined by sufficient details and guidelines. These requisites are not met by the UAE regulation. There is a need to develop timely disclosure rules in the UAE through comparison with the UK, US and DIFC rules.

⁵¹⁷ TOJAN AL SHURIDEH, Legal Consultant, Securities and Commodities Authority *Interview Transcript*. See Appendix 6, Interview (3).

This part will discuss disclosure provisions contained in securities regulation, not in company law. It is a well established principle in company law that shareholders should have access to information related to the corporate. Disclosure provisions of company law are mainly directed at shareholders, but they are also partly directed towards potential investors and markets. That is why company law requires annual accounts to be publicized through filing at Companies House. Yet, disclosure provisions of company law are limited in their meeting the needs of investors and markets. It is the task of securities regulation to establish transparency in the market place through disclosure rules. In fact, disclosure is the predominant principle of securities market regulation. It is usual that prospectus rules, listing rules and continuous disclosure rules contain provisions aimed at informing the investor in decision-making. Therefore, it can be said that the function of enforcing the disclosure of information to potential investors and markets has been transferred from company law to securities regulation. This is also supported by the European Commissions' High Level Group of Company Law Experts, who remark that:

Information and disclosure is an area where company law and securities regulation come together. It is a key objective of securities regulation in general to ensure that market participants have sufficient information in order to participate in the market on an informed basis. Where the relevant security is a share in a company, the information required from a securities regulation point of view overlaps with information to be provided from a company law perspective.⁵¹⁸

Insider dealing may occur where there is inside information which has not yet been disclosed to the market. If price-sensitive information is made public, there is hardly any opportunity for insiders to exploit it. It is therefore essential to encourage the disclosure of as much information as possible into the market, a task which is expected to be achievable by disclosure rules. However, in reality disclosure rules are not mainly directed to discouraging insider dealing. They are the best preventive correlate for discouraging insider dealing, but they do not render a prohibition on insider dealing unnecessary. Thus, the limited function of disclosure rules in discouraging insider dealing is an argument for, not against, explicit prohibition of insider dealing.⁵¹⁹

There is a common scope between rules directed to prohibiting insider dealing and disclosure rules. This scope has varied in the history of regulating insider dealing. Probably

⁵¹⁸ *Report of the High Level Group of Company Law Experts on a Modern Regulatory Framework for Company Law in Europe* (Brussels, November 4, 2002), Ch. II.3.

⁵¹⁹ KLAUS J. HOPT *Insider Dealing and Timely Disclosure* (The Netherlands: Kluwer Law International, 1996), p. 10.

the most prominent precedent in which disclosure rules and insider dealing rules were linked was in the US rule of “disclose or abstain”. This rule was first adopted by the SEC in the case of *In re Cady Roberts & Co.*⁵²⁰ The SEC adopted it to extend the scope of Rule 10b-5 to capture those outside an issuer. The SEC reasoned that such a decision as the duty or obligation of corporate insiders could, in certain circumstances, be extended to those outside the corporation. . The ‘disclose or abstain’ rule is in part based on disclosure and equality of information principles. According to this rule there can be ‘temporary’ or ‘constructive’ insiders who possess material non-public information. They have to disclose such information or abstain from dealing until the information is made public. The SEC ruling in *Cady* was supported by a federal circuit court in the case of *SEC v. Texas Gulf Sulphur Co.*⁵²¹

In this conception, the prohibition of insider dealing under Rule 10b-5 is seen as intended to be a part of the disclosure system. The regulation of insider dealing is a method of increasing the flow of information into the market. This, in turn, contributes to the establishment of an informed market where securities can be accurately priced. Such a process is crucial to the economy, since an informed market contributes to the efficient allocation of capital resources. The issuer is in a position which allows monopoly information to be generated inside it. But, as regards disclosure, the issuer has more incentives to disclose positive rather than negative information. Insiders may also evade disclosure of information if they can exploit it for their own benefit. Therefore, a disclosure system should be mandated by a regulatory body to ensure compliance with the system.⁵²²

This is the responsibility of the SEC in the US and the FSA in the UK.

In the context of disclosure requirements for an informed market, it is reasonable to question whether the ‘disclose or abstain’ rule added a significant contribution to the disclosure system. This rule, as interpreted by the courts and the SEC in the US, makes a contribution to the disclosure objective through removing an incentive to delay the release of corporate information. That prohibition of insider dealing contributes to the disclosure object as a reasonable supposition. But it is easy to argue that the ‘disclose or abstain’ rule is an incorrect interpretation of Rule 10b-5.

⁵²⁰ *In re Cady Roberts & Co.* 40 SEC 907 (1961).

⁵²¹ *SEC v. Texas Gulf Sulphur Co.*, 401 F.2d 833 (2d Cir. 1968), cert. denied, 394 U.S. 976 (1969).

⁵²² KENNETH E. SCOTT ‘Insider Trading: Rule 10b-5, Disclosure and Corporate Privacy’ (1980) 9 *Journal of Legal Studies* 801.

The ‘disclose or abstain’ rule is imbalanced and raises the question of whether Rule 10b-5 can be read as a disclosure rule. Under the former, the company and its insiders are able to avoid disclosure by not trading. In other words, the rule does not state an affirmative duty on issuers and insiders to disclose inside information. Rather, the rule affords a choice of non-disclosure where there is no trading.⁵²³ In fact, historically in the US the courts and the SEC declined to identify an affirmative duty on issuers of publicly traded securities to make timely disclosure of material information. This has been the case until recent amendments. In the 2001 case of *Gallagher v. Abbott Laboratories*, plaintiffs contended that Abbott Laboratories breached Section 10(b) and SEC Rule 10b-5 by postponing public disclosure of material information regarding penalties on the company. However, the court of the seventh circuit stated that: “Much of plaintiffs’ argument reads as if firms have an absolute duty to disclose all information material to stock prices as soon as news comes into their possession. Yet that is not the way the securities laws work. We do not have a system of continuous disclosure. Instead firms are entitled to keep silent (about good news as well as bad news) unless positive law creates a duty to disclose”.⁵²⁴

It is difficult to read the insider dealing provisions as disclosure rules, because that sends confusing message in terms of who is obliged to disclose inside information. It does not seem appropriate to oblige insiders to disclose inside information. The issuer, not the insider, should be perceived as the entity responsible for disclosure. Disclosure is not an automatic release of information into the market. Rather, there are certain procedures to be followed in disclosing information and there are exempted circumstances in which the commercial interests of the issuer are protected. Only the issuer should be compelled to disclose inside information in accordance with the disclosure rules. Therefore, it was inevitable to amend the position in the US. This was through recognising affirmative duty on issuers to make timely disclosure.⁵²⁵

The above discussion attempted to represent the distinction between the rules of insider dealing and of timely disclosure. It is proper that insider dealing regulation and disclosure

⁵²³ KENNETH E. SCOTT ‘Insider Trading: Rule 10b-5, Disclosure and Corporate Privacy’ (1980) 9 *Journal of Legal Studies* 801. pp. 811-2.

⁵²⁴ *Gallagher v. Abbott Laboratories*, 269 F.3d 806. 809-811. (7th Cir. 2001).

⁵²⁵ This was through Section SOX § 409, amending Section 13(1) of the Securities Exchange Act: “Each issuer reporting under section 13(a) or 15(d) shall disclose to the public on a rapid and current basis such additional information concerning material changes in the financial condition or operations of the issuer, in plain English, which may include trend and qualitative information and graphic presentations, as the Commission determines, by rule, is necessary or useful for the protection of investors and in the public interest.”

rules have a common object of maintaining an informed market. This does not mean that the rules prohibiting insider dealing should be read as affirmative disclosure rules. It is more accurate to say that disclosure principles are the basis of securities regulation. And while rules prohibiting insider dealing and disclosure rules overlap in support of the aspirations underlying securities regulation, they differ in the roles they play in achieving the goals of the disclosure system. Insider dealing regulation principally has a preventive function. This is to remove an incentive to delay disclosure and exploit inside information. On the other hand, disclosure rules have a protective function, since they are designed to maintain a flow of information in order to help maintain an informed market where the prices of securities best reflect the disclosed information.⁵²⁶

Timely disclosure of inside information

A company might be subjected to various disclosure obligations. In the stage of establishing a company, raising capital or promotion, promotional disclosure obligations are encountered. The company also encounters continuous disclosure obligations which aim to provide sufficient information for all those dealing with it. Promotional and continuous disclosure is usually governed by the requirements of company law. Securities market regulation may overlap with the requirements of company law in regard to promotional and continuous disclosure. Nevertheless, for financial markets, timely disclosure is the most important factor. This kind of disclosure is essential for the pricing of securities, since it involves information which is reasonably considered to have an effect on the price of securities. Securities market regulation aspires to maintain a transparent and informed market. It is vital to release as much relevant information as possible into the market to ease making investment decisions. Therefore, securities market regulation requires issuers to adopt a timely disclosure policy for all information which is reasonably expected to have an effect on the price of their securities.⁵²⁷

Recent years have experienced rapid progress regarding timely disclosure requirements. This has been due to the response of leading financial markets to financial scandals, as was the case in the US. The cases of Enron and WorldCom called into question the reliability of corporate financial disclosure. Enron and WorldCom were the main examples of scandals

⁵²⁶ VICTOR BRUDNEY 'Insiders, Outsiders, and Informational Advantages under the Federal Securities Laws' (1979) 93 *Harvard Law Review* 322. pp. 333-4.

⁵²⁷ KLAUS J. HOPT *Insider Dealing and Timely Disclosure* (The Netherlands: Kluwer Law International, 1996). pp.11-2.

of corporation's hiding their true financial conditions from creditors and shareholders. This resulted in a bubble in their securities prices. The inability of these corporations to meet their financial commitments forced them to restate their big losses. This resulted in bankruptcies and considerable losses in the financial industry in the US. The Federal Government responded to the scandal by introducing the Sarbanes-Oxley Act 2002, imposing significant responsibilities on corporate management, auditors and attorneys. This act provides safeguards to ensure the reliability of financial reports and statements.⁵²⁸ The SEC implementing Sarbanes-Oxley Act 2002 introduced the first rule obligating issuers to disclose to the public on a rapid and current basis such additional information concerning material changes in order to protect investors and the markets.⁵²⁹

Another reason for introducing more strict disclosure requirements has been the need to meet international standards. This has been the case in the UK's implementation of the Market Abuse Directive.⁵³⁰ The FSA, in its Handbook, included Disclosure Rules which, in turn, had been determined primarily through the implementation in the UK of the Market Abuse Directive. The issuer disclosure requirements, through the Market Abuse Directive, were aimed at preventing market abuse and insider dealing by ensuring that the market was informed through prompt and fair disclosure of information.⁵³¹

Securities market regulation has rapidly developed more rigid timely disclosure requirements in recent years. There are currently explicit requirements in the regulations regarding the "disclosure and control of *inside information*". Recognized securities regulation comprehends the importance of inside information, and therefore imposes many regulatory requirements on it. In this regard, there are two issues which need to be explained: firstly, the developments in the concept of inside information in securities market regulation; secondly, the concept of inside information is important as many regulatory duties derive from it.

⁵²⁸ P.N. SAKSENA AND MARK A. FOX 'Accounting Fraud and the Sarbanes-Oxley Act' (2004) 8 *International Company and Commercial Law Review* 244. For more in-depth information see JOHN ARMOUR AND JOSEPH A. MCCAHERY *After Enron: Improving Corporate Law and Modernising Securities Regulation in Europe and the US* (Oxford: Hart, 2006).

⁵²⁹ See footnote 525.

⁵³⁰ Directive 2003/6/EC of 28 January 2003 on insider dealing and market manipulation (market abuse) [2003] OJL 96/16. In particular Article 6(1) "Member states shall ensure that issuers of financial instruments inform the public as soon as possible of inside information which directly concerns the said issuers".

⁵³¹ MAURICE BUTTON *A Practitioner's Guide to the Financial Services Authority Listing Rules* (London: City and Financial Publishing, 2005/2006). p.140.

In regard to the concept of inside information, the definition of inside information has been discussed,⁵³² revealing the importance of determining the scope of the definition. The scope of the definition of inside information must be broad enough to ensure the primary objective of maintaining an informed and transparent market. On the other hand, the scope of the definition must not be so broad as to be an obstacle to research, analysis and use of public information. In this chapter, it should be added that securities market regulation is increasingly adopting a single definition which applies to the general obligation of disclosure and the prohibition on inside dealing and market abuse. To illustrate this, in the UK the previous Listing Rules required the disclosure of non-public, price-sensitive information, while the new Disclosure and Transparency Rule (DTR) 2.2.1R⁵³³ requires issuers to disclose as soon as possible any *inside information*. The definition of inside information in Section 118C(2) applies to both the disclosure obligations and the offences of insider dealing and market abuse. This approach makes it easier for issuers to meet the regulatory obligations. More importantly, the adoption of a single definition of inside information emphasizes the relationship between different obligations covering inside information.⁵³⁴

The adoption of a single concept of inside information confirms the relationship between the “positive” continuing obligation of timely disclosure and the “negative” prohibition on insider dealing. In this perception, the central concept is inside information and there must be a single definition for it. The positive obligation to promptly, clearly and accurately disclose inside information maintains an informed market and, peripherally, prevents insider dealing. In contrast, the absence of clear obligations in regard to the disclosure and control of inside information increases the opportunities of the leak of inside information and insider dealing.

Recognized jurisdictions are progressively acknowledging the purpose of rules directed to the disclosure and control of inside information. Such declarations are helpful in comprehending the disclosure requirements. The FSA Handbook DTR 2.1.3G confirms the purpose of the rules directed to the disclosure and control of inside information by issuers.

⁵³² See above heading: Part 2 inside information.

⁵³³ The FSA Handbook under the Disclosure Rules and Transparency Rules (DTR) contains legal rules abbreviated by DTR *number* R, as well as guides abbreviated by DTR *number* G. The latter are not legal rules and are interpreted as mere non-obligatory guides.

⁵³⁴ MARSH, JONATHAN *A Practitioner's Guide to Inside Information: Managing the Regulatory Risks* (Old Woking: City and Financial Publication, c2006). p.6.

It is clear that one objective of the rules is to prevent insider dealing.⁵³⁵ In the FSA Handbook DTR 2.1.1G, it is also clear that the disclosure rules are related to insider dealing.⁵³⁶

The regulation of the ‘disclosure and control of inside information’

Securities markets regulation should contain rules directed to oblige an issuer to protect and disclose inside information. Hence, this will contribute both to the maintenance of an orderly market of the issuer’s securities, and to the prevention of insider dealing and leak of inside information.

In the UK, under DTR 2.2.1R of FSA Handbook,

An issuer must notify a Regulatory Information Services (RIS) as soon as possible of any inside information which directly concerns the issuer.

Under the previous regime, the requirement was to disclose ‘information which was not public knowledge and which, if known, would lead to a substantial movement in the price of its listed securities. Therefore, it is apparent that the new rule makes it clear that the issuer is required to disclose inside information.

The disclosure obligation in DTR 2.2.1R implements Section 397 of FSMA. Under this section, an issuer is prohibited from dishonest concealment of material facts. Thus, there is a positive duty to disclose inside information under the FSA Handbook Disclosure Rules and Transparency Rules. The issuer’s failure to comply with such a duty may give rise to dishonest concealment of material fact under Section 397 FSMA.⁵³⁷

It should also be noted that there are other rules which the FSA can depend on to prevent any misleading disclosure. Thus, not only is disclosure of inside information important, but

⁵³⁵ It is stated that “The purpose of this chapter is to:

(1) promote prompt and fair disclosure of relevant information to the market; and
(2) set out specific circumstances when an issuer can delay public disclosure of inside information and requirements to ensure that such information is kept confidential in order to protect investors and prevent insider dealing.”

⁵³⁶ “An issuer should be aware that matters that fall within the scope of this chapter may also fall within the scope of:

(1) the market abuse regime set out in section 118 of the Act;
(2) section 397 of the Act relating to misleading statements and practices;
(3) Part V of the Criminal Justice Act 1993 relating to insider dealing; and
(4) the Takeover Code.”

⁵³⁷ MAURICE BUTTON *A Practitioner’s Guide to the Financial Services Authority Listing Rules* (London: City and Financial Publishing, 2005/2006). p.144.

also that disclosure should be clear, not misleading or deceptive. The FSA reached a vital decision depending on Listing Rules in the case of *Shell* as follows:

The FSA fined the Shell Transport and Trading Company (STT) the Royal Dutch Petroleum Company (RDP) and the Royal Dutch/Shell Group of Companies (Shell) £17 million for committing market abuse and breaching the listing rules. Shell announced false or misleading information regarding reserves throughout the period 1998 to 2003. The size of the penalty indicates the seriousness of the misconduct by Shell. It made false or misleading announcements, despite warnings from 2000 to 2003 that its proved reserves, as announced to the market, were false or misleading. It did not correct the misleading information until a series of announcements between 9 January and 4 May 2004, that the company announced the re-categorization of the equivalent of 4,470 million barrels of oil which is approximately 25% of Shell's proved reserves. Shell failed to meet its obligations of maintaining adequate systems and controls to estimate its reserves and report correct information. Following Shell's first announcement regarding the re-categorization of proved reserves on 9 January 2004, the market price of STT's shares fell from 401p to 371p (7,5%). The market capitalization of STT declined on the same day by approximately £2,9 billion.⁵³⁸

The FSA found that, by reason of their behaviour, STT and RDP had failed to take all reasonable care to ensure that the information it announced regarding its proved reserves in the period 1998 to 2003 were not misleading, false or deceptive. The FSA found that this behaviour amounted to breach of the Listing Rules 9.3A and 17.2A (applicable at the time)⁵³⁹ which provide that listed issuers:

must take all reasonable care to ensure that any statement or forecast or any other information it notifies to a Regulatory Information Service or makes available through the UK Listing Authority is not misleading, false or deceptive and does not omit anything likely to affect the import of such statement, forecast or other information.

The FSA considered that Shell had also breached the original Section 118(2)(b) of the FSMA 2000. Because of the false or misleading information announced by Shell regarding

⁵³⁸ FINANCIAL SERVICES AUTHORITY, Final Notice, *The "Shell" Transporting and Trading Company, p.l.c. ("STT") and The Royal Dutch Petroleum Company NV ("RDP")*, 24 August 2004. pp.1-9.

⁵³⁹ *ibid.*, p.13.

its proved reserves, a regular user of the market was, and was likely to have been, given a false or misleading impression as to the price or value of UK listed Shell shares.⁵⁴⁰

Andrew Procter, Director of Enforcement at the FSA, said:

The FSA views timely and accurate disclosure to shareholders and markets as fundamental to maintaining the integrity of the UK's financial markets. The size of the penalty in this case reflects the seriousness of Shell's misconduct and the impact it had on markets and shareholders.⁵⁴¹

It is apparent that the same function of obligating issuers to make timely disclosure of inside information is fulfilled by the US law⁵⁴² and the DIFC law⁵⁴³.

Legal uncertainty and providing examples

The rules of timely disclosure give rise to a number of legal problems, just as is the case in the rules relating to insider dealing. One important issue which needs to be solved by timely disclosure rules is the legal uncertainty regarding "information to be disclosed". This issue arises due to requests by practitioners and market players for clarification of the kind of information to be disclosed, and therefore clarification of the responsibilities of issuers. While such a request is explicable, it is difficult to fulfil because of the generality and uncertainty of legal rules. The best solution to avoid legal uncertainty appears to be the introduction of a list of examples. Nevertheless, a wide list might be required in order to

⁵⁴⁰ *ibid.*, p.11.

⁵⁴¹ FINANCIAL SERVICES AUTHORITY, Press Release, *FSA fines Shell 17,000,000 for market abuse*, 24 August 2004.

⁵⁴² See footnote 525. Also the New York Stock Exchange (NYSE)⁵⁴² in its Listed Company Manual promulgates the following rule:

202.05 Timely Disclosure of Material News Developments.

A listed company is expected to release quickly to the public any news or information which might reasonably be expected to materially affect the market for its securities. This is one of the most important and fundamental purposes of the listing agreement which the company enters into with the Exchange.

⁵⁴³ Markets Law, DIFC Law No.12 of 2004, promulgates the following rule:

23. Publication and reporting of continuous disclosures.

(1) A Reporting Entity shall make disclosures to the market in the circumstances prescribed by the OSR.

(2) Without limiting the generality of Article 23(1), the OSR shall prescribe the circumstances in which the following types of information shall be disclosed:

(a) financial information;

(b) any material information which may have an effect on the market price or value of the Securities; and

(c) any material change which occurs in relation to a Reporting Entity.

The DFSA, in turn, under the Offered Securities Rules (OSR) communicated the following rule:

8.2.1 (1) A Reporting Entity must make timely disclosure of Material Information, including the relevant matters set out in App. 2, in accordance with this chapter.

(2) A Reporting Entity must ensure that its disclosure is complete, true, plain and not misleading, false or deceptive

give examples of the most important, as well as the infrequent, ‘information to be timely disclosed’.⁵⁴⁴

In response to the uncertainty, NYSE, in its Listed Company Manual, gives a few examples, rather than an exhaustive list of relevant information.⁵⁴⁵

In the UK, DTR 2.2.1R of FSA Handbook makes it clear that ‘inside information’ is to be disclosed.⁵⁴⁶ This rule states that the issuer must disclose “...inside information which *directly concerns* the issuer”. Thus, inside information which indirectly concerns the issuer, which is relevant for the purpose of insider dealing prohibition, is not relevant for this rule.⁵⁴⁷

⁵⁴⁴ KLAUS J. HOPT *Insider Dealing and Timely Disclosure* (The Netherlands: Kluwer Law International, 1996). pp.11-2.

⁵⁴⁵ Rule 202.06 states: Annual and quarterly earnings, dividend announcements, mergers, acquisitions, tender offers, stock splits, major management changes, and any substantive items of unusual or non-recurrent nature are examples of news items that should be handled on an immediate release basis. News of major new products, contract awards, expansion plans, and discoveries very often fall into the same category. Unfavorable news should be reported as promptly and candidly as favorable news. Reluctance or unwillingness to release a negative story or an attempt to disguise unfavorable news endangers management's reputation for integrity. Changes in accounting methods to mask such occurrences can have a similar impact.

⁵⁴⁶ Inside information is defined in Section 118C FSMA.

⁵⁴⁷ The FSA Handbook offers guidance on how to identify inside information as follows:

DTR 2.2.3G

Information is inside information if each of the criteria in the definition of inside information is met.

DTR 2.2.4G

(1) In determining the likely price significance of the information, an issuer should assess whether the information in question would be likely to be used by a reasonable investor as part of the basis of his investment decisions and would therefore be likely to have a significant effect on the price of the issuer's financial instruments (the “reasonable investor test”).

(2) In determining whether information would be likely to have a significant effect on the price of financial instruments, an issuer should be mindful that there is no figure (percentage change or otherwise) that can be set for any issuer when determining what constitutes a “significant effect on the price of the financial instruments”, as this will vary from issuer to issuer.

DTR 2.2.5G

The reasonable investor test requires an issuer:

(1) to take into account that the significance of the information in question will vary widely from issuer to issuer, depending on a variety of factors such as the issuer's size, recent developments and the market sentiment about the issuer and the sector in which it operates; and

(2) to assume that a reasonable investor will make investment decisions relating to the relevant financial instrument to maximise his economic self interest.³

DTR 2.2.6G

It is not possible to prescribe how the reasonable investor test will apply in all possible situations. Any assessment should take into consideration the anticipated impact of the information in light of the totality of the issuer's activities, the reliability of the source of the information and other market variables likely to affect the relevant financial instrument in the given circumstances. However, information which is likely to be considered relevant to a reasonable investor's decision includes information which affects:

- (1) the assets and liabilities of the issuer;
- (2) the performance, or the expectation of the performance, of the issuer's business;
- (3) the financial condition of the issuer;
- (4) the course of the issuer's business;

Timely disclosure in the DIFC is regulated by the DFSA in the Offered Securities Rules (OSR), Rule 8.2.1 (1). A Reporting Entity must make timely disclosure of *Material Information*, including the relevant matters set out in (App.2)⁵⁴⁸ in accordance with this chapter.

It is not stated in the OSR that *material information* relevant for the purpose of timely disclosure is the same as that relevant for prohibiting insider dealing. Nevertheless, because the same term is used, it appears to be acceptable that the definition of material information introduced in Markets Law, DIFC Law No.12 of 2004, is relevant for the purpose of timely disclosure.⁵⁴⁹

As to the second clause of Rule 8.2.1 (1), “*including* the relevant matters set out in (App.2) in accordance with this chapter”, the term *including* appears to indicate that the relevant matters in (App.2) are non-exhaustive examples of events that require disclosure by the Reporting Entity.

The OSR, unlike the regulation in the UK or US, has taken a further step, through the introduction of an extensive list of events in which a reporting entity is required to disclose information. The list also mentions the specific requirement in each event and the time in which requirement should be fulfilled. According to the table provided in (App.2), on the occurrence of an event in the “events” column, a Reporting Entity must make a type of disclosure in accordance with the “requirements” column and the “time” column.⁵⁵⁰ The list appears to be introducing non-exhaustive examples of situations where information amounts to ‘material information’, but such a list is perceived to be valuable for Reporting Entities in meeting their obligations. This is a bold idea in providing extensive guidance in a jurisdiction where there is no established customs or precedents which help issuer to become compliant with the rules.

Issuer’s responsibility of identifying inside information

It should be noted that it is the issuer’s responsibility to identify ‘inside information’, and therefore meet its obligations of disclosing and controlling it. Modern securities markets regulations state clearly that issuers have to establish adequate procedures to comply with

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- (5) major new developments in the business of the issuer; or
 - (6) information previously disclosed to the market.

⁵⁴⁸ See Appendix 7: A copy of part of (App2) of the DFSA Rulebook Offered Securities Rules (OSR).

⁵⁴⁹ Material information is defined under Markets Law, DIFC Law No.12 of 2004, Article (45). Definitions of material information and special relationship for this Part.

⁵⁵⁰ See footnote 548.

their obligations. Thus, if the issuer has not taken the necessary measures to monitor changes in the circumstances, it is not a defence for an issuer that it was not aware of the inside information.

The UK, the FSA Handbook makes it clear that identifying inside information is the responsibility of the issuer.⁵⁵¹ In the DIFC, the OSR in App. 7 Guidance 4 follows a similar line to the FSA.⁵⁵²

Also, the FSA Handbook in Listing Principle 2 requires listed companies to establish and maintain adequate procedures, systems and controls to enable them to comply with their obligations. An issuer may comply with such a requirement by appointing a committee specialized in implementing and monitoring the issuer's disclosure procedures. The issuer, in establishing a disclosure system, should ensure that it monitors circumstances where a disclosure obligation arises and can decide whether particular information amounts to inside information.

When to disclose inside information

It is acceptable that an issuer needs a small delay in order to prepare a clear statement for disclosure. However, regulation does not allow for a longer time than necessary to prepare for disclosure. In other words, there is usually a short time during which disclosure should be made.

In the US, the NYSE Listed Company Manual, in rule 202.05, requires material information to be “quickly” disclosed into the market.

In the UK, an issuer is required to disclose inside information “as soon as possible” to a Regulatory Information Service (RIS). Under the previous regime, an issuer was required to disclose price-sensitive information “without delay”. The FSA has declared that it considers that the change from “without delay” to “as soon as possible” would not mean that an issuer is allowed to take a longer time to disclose inside information into the market. Thus,

⁵⁵¹ DTR 2.2.7G

An *issuer* and its advisers are best placed to make an initial assessment of whether particular information amounts to *inside information*. The decision as to whether a piece of information is *inside information* may be finely balanced and the *issuer* (with the help of its advisers) will need to exercise its judgment.

DTR 2.2.8G

The *directors* of the *issuer* should carefully and continuously monitor whether changes in the circumstances of the *issuer* are such that an announcement obligation has arisen under this chapter.

⁵⁵² ...The Reporting Entity is itself best placed to determine whether information is liable to lead to substantial movement in the price of its Securities, as what constitutes Price Sensitive Information will vary widely according to circumstances.

precedents under the previous regime in regard to when to disclose inside information are still relevant.⁵⁵³

In particular, the leading FSA enforcement decision interpreting the term “without delay” is the public censure of Marconi Plc in April 2003. The applicable rule in the case then was paragraph 9.2C of the previous FSA Listing Rules. Accordingly, the FSA decided that Marconi failed to make an announcement “without delay” of a change in its expected performance for the half-year ended 30 September 2001 and the full-year ended 31 March 2002. The expected change in Marconi’s performance had been approved by Marconi’s chief executive and chief financial officer on the afternoon of 2 July 2001. Yet, an announcement was not made until after the market close on 4 July 2001, following its discussion at a board meeting. The delay of the announcement had a considerable effect on the market price of Marconi’s securities on the 5 July 2001; there was a 54 per cent fall in its share price. The FSA judged that Marconi did not meet the requirement of disclosure “without delay”. In its consideration, once the change in expected performance had been agreed on the afternoon of 2 July 2001, the issuer should have immediately taken the necessary action to move forward its board meeting to a time no later than the afternoon of 3 July 2001. This would have allowed it to disclose the information into the market by, at least, the evening of 3 July 2001. The FSA’s enforcement decision in the Marconi case reveals an interpretation of the term “without delay”. This line of judgment is still relevant under the new regime, as the FSA clearly stated that this is also the case under the new disclosure rules.

In its decision in the Marconi case, the FSA emphasized the importance of timely disclosure of inside information. The case indicates that an issuer is allowed a small delay in order to prepare a clear not-misleading statement. But the FSA will investigate the steps taken to make an announcement, if it is clear that a timely disclosure is required. The case indicates that the FSA gave Marconi approximately 24 hours to make a disclosure. This might be an indication of the time during which disclosure must be made. But it should be noted that in its decisions the FSA takes into consideration the circumstances surrounding each individual case.⁵⁵⁴

⁵⁵³ FSA June 2004 Consultation, Paragraph 4.51.

⁵⁵⁴ MAURICE BUTTON *A Practitioner’s Guide to the Financial Services Authority Listing Rules* (London: City and Financial Publishing, 2005/2006). pp.145-6.

The position in the UK can be compared to that in the DIFC. In the latter, the DFSA’s OSR in App. 2 introduced an extensive list of events in which a reporting entity is required to disclose information. According to the table provided in App. 2, on occurrence of an event in the “events” column, a Reporting Entity must make the type of disclosure in accordance with the “requirements” column and the “time” column. In regard to the “time” column, a reporting entity must disclose price-sensitive information “without delay”. It is clear that most of the disclosure requirements in App. 2 must be fulfilled “without delay”. Only in some events, such as in disclosing information in respect of a new director within 7 days of appointment, does App. 2 allow for a longer time.

The term “without delay” is not defined by the OSR. It is not clear, in the absence of precedents, what “without delay” means. It can be supposed that the FSA’s line of reasoning in Marconi is appropriate here. This is supported by the fact that the same term is used, and that the jurisdiction of the DIFC is based on the legal system of England and Wales.

Holding announcement

In practice not all events are clear and can be immediately announced. Where there is an unexpected and significant event, the issuer needs more time to elucidate the situation. Otherwise an immediate announcement might cause false, non-detailed or misleading disclosure. Allowing issuers to make a holding announcement seems to be the best solution in such situations.

The FSA Handbook in DTR 2.2.9G allows holding announcement.⁵⁵⁵ The same is right in the DIFC.⁵⁵⁶

⁵⁵⁵ (2) If an *issuer* is faced with an unexpected and significant event, a short delay may be acceptable if it is necessary to clarify the situation. In such situations a holding announcement should be used where an *issuer* believes that there is a danger of *inside information* leaking before the facts and their impact can be confirmed. The holding announcement should:

- (a) detail as much of the subject matter as possible;
- (b) set out the reasons why a fuller announcement cannot be made; and
- (c) include an undertaking to announce further details as soon as possible.

⁵⁵⁶ App. 7 under the OSR provides guidance 5, which states:

Reporting Entities must disclose Price Sensitive Information without delay. In practice, a short period before announcing Price Sensitive Information is permitted where a Reporting Entity is affected by an unexpected event and the Reporting Entity needs to clarify the situation so that any information released is accurate and not misleading. Where there is a danger of information leaking out in the meantime, the Reporting Entity should make a holding announcement giving an outline of the subject matter of the announcement, the reasons why a full announcement cannot yet be made and undertaking to give a full announcement as soon as possible.

Delaying disclosure of information

There are circumstances in which an issuer needs a dispensation from the disclosure requirement. Exempting an issuer from a disclosure requirement should be limited to circumstances where such disclosure prejudices the issuer's legitimate interests. Given that there are different interests of issuers, investors and the market, there should be a regulatory balance of such interests and a clear exemption from the disclosure obligation. This would avoid misunderstanding and abuse of the exemption.⁵⁵⁷

In the US, it is established that both the SEC and the courts have accepted the principle of temporarily withholding material information from the market if there are legitimate business interests, given that neither the issuer nor insiders exploit such information in trading.⁵⁵⁸

This is supported by the leading case *Texas Gulf Sulphur*, where the Second Circuit affirmed that:

We do not suggest that material facts must be disclosed immediately; the timing of disclosure is a matter for the business judgment of the corporate officers entrusted with the management of the corporation within the affirmative disclosure requirements promulgated by the exchanges and by the SEC.⁵⁵⁹

In the UK, an issuer is allowed to delay disclosure of inside information in limited circumstances under the FSA Handbook.⁵⁶⁰ The FSA Handbook makes it clear that an issuer's legitimate interests in this framework include matters in negotiation and impeding developments. Its emphasis is on circumstances where the viability of the issuer is in danger, or where immediate public disclosure jeopardizes the outcome of negotiations. This does not mean that an issuer is allowed to delay disclosure of the fact that it is in financial difficulty. The FSA directed that issuers should distinguish between an event which gives

⁵⁵⁷ KLAUS J. HOPT *Insider Dealing and Timely Disclosure* (The Netherlands: Kluwer Law International, 1996). p.15.

⁵⁵⁸ LOUIS LOSS AND JOEL SELIGMAN (eds.) *Fundamentals of Securities Regulation* (New York 5th ed.: Aspen Publishers, c2004). pp. 950-1.

⁵⁵⁹ *SEC v. Texas Gulf Sulphur*, 401 F.2d 833, 850 n.12 (2d Cir. 1968).

⁵⁶⁰ DTR 2.5.1R:

An issuer may, under its own responsibility, delay the public disclosure of *inside information*, such as not to prejudice its legitimate interests provided that:

- (1) such omission would not be likely to mislead the public;
- (2) any person receiving the information owes the issuer a duty of confidentiality, regardless of whether such duty is based on law, regulations, articles of association or contract; and
- (3) the issuer is able to ensure the confidentiality of that information.

rise to an obligation to disclose inside information under DTR 2.2.1R (e.g., the loss of an important contract) and subsequent events in which the issuer may be allowed to delay disclosure (e.g., attempts to re-negotiate the contract).⁵⁶¹

In the DIFC, the laws and regulations fulfil the same function of allowing issuers to delay disclosure in certain circumstances. It is clear that impeding and strategic developments can be withheld from disclosure, benefiting from the disclosure exemption provisions. Where there is a risk of breach of confidence, information must be disclosed. Thus, the disclosure exemption provisions in both the UK and the DIFC are likely to have a similar effect.⁵⁶²

Selective disclosure

Allowing selective disclosure in limited circumstances is another example of recognizing the propriety of preserving issuers' legitimate interests in the regulation of modern securities markets. For a long time, it has been ascertained that an issuer may not selectively disclose inside information, for example, to one or a few financial analysts or institutional investors.⁵⁶³

⁵⁶¹ FSA June 2004 Consultation, Paragraph 4.53.

⁵⁶² Markets Law, DIFC Law No.12 of 2004, Article (24) states:

24. Disclosure exceptions

(1) Where in the reasonable opinion of a Reporting Entity the disclosure required by the Offered Securities Rules made pursuant to Article 23 would:

(a) be unduly detrimental to the interests of the Reporting Entity; or

(b) disclose commercially sensitive material,

the Reporting Entity need not make the disclosure but shall immediately file with the DFSA a confidential report together with written reasons for non-disclosure.

The OSR, Rule 8.3 states:

8.3 Disclosure exceptions

8.3.1 (1) A Reporting Entity who intends not to disclose information it would, but for Article 24(1) of the Markets Law 2004, be required to disclose under this chapter must notify the DFSA by written notice setting out:

(a) a confidential report setting out the relevant information that it would, but for Article 24(1) of the Markets Law 2004, be required to disclose under the Rules; and

(b) the reason why the Reporting Entity believes on reasonable grounds that the relevant information would fall within the grounds prescribed under Article 24(1) of the Markets Law 2004.

Also, App. 7 under the OSR provides guidance 9, which states:

Article 24 of the Markets Law 2004 provides exemptions to the requirement to provide disclosure of Price Sensitive Information, where disclosure would be unduly detrimental to the interests of the Reporting Entity or Listed Fund or where the information to be disclosed is commercially sensitive. Reporting Entities should ensure that any such information is kept confidential within the Reporting Entity. In these circumstances, the Reporting Entity should deliver without delay to the DFSA a notification requesting non-disclosure as set out in Rule 8.3 of the Offered Securities Rules.

In App. 2, a reporting entity is required to disclose price-sensitive information without delay in relation to:

1(c) (c) impending or strategic developments or matters in the course of negotiations where there is reason to believe that a breach of confidence has or is likely to occur in relation to Price Sensitive Information.

⁵⁶³ LOUIS LOSS AND JOEL SELIGMAN (eds.) *Fundamentals of Securities Regulation* (New York 5th ed.: Aspen Publishers, c2004). p.951.

In the US, in *Dirks* the Supreme Court noted that:

“The SEC views the disclosure duty as requiring... a broad dissemination to the investing public generally and without favoring any special person or group”.⁵⁶⁴

Thus, under the previous regime in the US, a selective disclosure may amount to a “tip” actionable under insider dealing prohibition in Rule 10b-5.⁵⁶⁵

However, arguments regarding the legitimacy of selective disclosure have continued. There were concerns about many issuers’ making selective disclosure of material information to securities analysts and institutional investors, before disclosing the same information to the public. In such cases, the recipients of material information can exploit that information at the expense of other informed investors. Such practices of selective disclosure have considerable effects on insider dealing. Both actions are detrimental to a transparent and informed market where investors have equal access to information. Yet, in the US, while insider dealing and tipping were prohibited by the antifraud provisions of the federal securities laws, the regulation of selective disclosure was not clear.⁵⁶⁶ Selective disclosure persisted as an issue until the adoption of Regulation Fair Disclosure (RFD) by the SEC in 2000.⁵⁶⁷

RFD, nevertheless, allows selective disclosure in limited circumstances. Rule 100(b) (2) states that general Rule 100(a) does not apply to a disclosure made to a person who owes a duty of trust and confidence, to a person who agrees to maintain the disclosed information in confidence, to an entity whose business is in credit rating or in connection with a registered securities offering.

In the UK, the FSA Handbook also establishes a general rule that disclosure should not be selective, but should rather be to the public in general.⁵⁶⁸

⁵⁶⁴ *Dirks v. SEC*, 463 U.S. 646, 653 n.12 (1983).

⁵⁶⁵ LOUIS LOSS AND JOEL SELIGMAN (eds.) *Fundamentals of Securities Regulation* (New York 5th ed.: Aspen Publishers, c2004). p.951.

⁵⁶⁶ SECURITIES AND EXCHANGE COMMISSION *Selective Disclosure and Insider Trading*, Release No. 43154.

⁵⁶⁷ Rule 100 of RFD establishes that the general rule is:

Whenever an issuer, or any person acting on its behalf, discloses any material non-public information regarding that issuer or its securities to any person described in paragraph (b) (1) of this section, the issuer shall make public disclosure of that information as provided in Rule 101(e)...

⁵⁶⁸ DTR 2.5.6R

Whenever an *issuer* or a person acting on his behalf or for his account discloses any *inside information* to any third party in the normal exercise of his employment, profession or duties, the *issuer* must make complete and effective public disclosure of that information via a *RIS*, simultaneously in the case of an intentional disclosure and as soon as possible in the case of a non-intentional disclosure, unless DTR 2.5.1 R applies.

However, when an issuer is allowed to delay public disclosure of inside information under DTR 2.5.1R, it may be selectively disclosed to another person, providing that the other person owes the issuer a duty of confidentiality.⁵⁶⁹ Selective disclosure to another person must be in the normal course of the exercise of his/her employment, profession or duties.⁵⁷⁰ The guidance introduces the idea that an issuer may, depending on the circumstances, be justified in disclosing inside information to the mentioned non-exhaustive categories.⁵⁷¹ The guidance, however, indicates that selective disclosure to any or all of the above-mentioned persons may not be justified in all circumstances.⁵⁷² The issuer should also consider that the wider the group of selective disclosure the greater the likelihood of a leak which raises a duty of public disclosure.⁵⁷³ In the DIFC, the function of regulating selective disclosure is fulfilled under OSR.⁵⁷⁴

⁵⁶⁹ DTR 2.5.7G(1).

⁵⁷⁰ DTR 2.5.7G(2).

⁵⁷¹ DTR 2.5.7G(2).

⁵⁷² DTR 2.5.8G.

⁵⁷³ DTR 2.5.9 G.

- (a) the *issuer's* advisers and advisers of any other *persons* involved in the matter in question;
- (b) *persons* with whom the *issuer* is negotiating, or intends to negotiate, any commercial financial or investment transaction (including prospective underwriters or places of the *financial instruments* of the *issuer*);
- (c) employee representatives or trade unions acting on their behalf;
- (d) any government department, the Bank of England, the Competition Commission or any other statutory or regulatory body or authority;
- (e) major shareholders of the *issuer*;
- (f) the *issuer's* lenders; and
- (g) credit-rating agencies.

⁵⁷⁴ SRO Article 8.2.3 states:

(1) A Reporting Entity must not disclose any information it is required to disclose by Rule 8.2.1 to any other person prior to the market disclosure in accordance with Rule 8.2.1(3) of such information, except in strict confidence to:

- (a) its advisors, underwriters, sponsors or compliance advisers;
- (b) the custodian of the Listed Fund to which the information relates;
- (c) the agent employed to release the information;
- (d) Persons with whom it is negotiating with a view to effecting a transaction or raising finance, including prospective underwriters or sponsors of an issue of Securities, providers of finance or loans or the placement of the balance of a rights issue not taken up by shareholders;
- (e) the DFSA or another Financial Services Regulator where such disclosure is necessary or desirable for the regulator to perform its functions;
- (f) a Person to whom the Reporting Entity discloses information in accordance with a lawful requirement; or
- (g) a Person to whom the information is disclosed in the necessary course of the business of the Reporting Entity.

(2) A Reporting Entity must advise such recipients, except the DFSA, in writing, prior to them receiving the information, that the information is confidential and that they and any person privy to the information should not deal in the relevant Securities, or any other related Investment, before the information has been made available to the market.

It is clear that in the three jurisdictions one essential condition for permitting selective disclosure is that the recipient should owe a duty of confidentiality to the issuer. Selective disclosure as a general rule is prohibited, and is only exceptionally permitted in limited circumstances. Where selective disclosure is permitted, there appears to be a safe-harbour of the prohibition from disclosing inside information. The DIFC, Rule 8.2.3 (2) indicates that the issuer must advise recipients not to deal in the relevant securities, depending on the information. In the UK, DTR 2.6.4G recognized that if a permitted recipient of inside information breaches his duty of confidentiality, the issuer may not be responsible for the breach. Thus, the regulation of selective disclosure is another example of the common scope between disclosure and insider dealing regulation.

A discussion regarding the disclosure of important information from financial or securities research is essential. Such information is supposed to be material and price-sensitive. However, in some jurisdictions it is considered, with reason, that such information is not inside information. This is because the information in these cases is generated outside the issuer by the analyst or the researcher. It is irrational to consider a person as an insider to his own thought; the law cannot regulate a person's relationship to his own thought. This is an important issue, which was formerly thought to comprise insider dealing through disclosure of inside information. Probably the most appropriate way to deal with this issue is to prohibit the inappropriate disclosure of research information.⁵⁷⁵

The named article was implemented by FSA's Code of Practice of Approved Persons (APER). The FSA also reached the following important decision:

Mr Casoni was a research analyst working for Citigroup's Global Equity Research (Citigroup) in London. He was head of a team specializing in the Italian leasing sector. His area of coverage included the Italian bank Banca Italease (BI). On 9 January 2006, Mr Casoni began the process for attaining approval of his research on BI, planning to publish his findings on 20 January. Between the date when he began the process for gaining approval and the expected date of publication, Mr Casoni selectively disclosed details of his research to certain clients of the firm regarding the valuation methodology and the target

⁵⁷⁵ Thus, Article 6(5) of the Market Abuse Directive states:

Member states shall ensure that there is appropriate regulation in place to ensure that persons who produce or disseminate research concerning financial instrument or issuers of financial instruments and persons who produce or disseminate other information recommending or suggesting investment strategy, intended for distribution channels or for the public, take reasonable care to ensure that such information is fairly presented and disclose their interests or indicate conflicts of interest concerning the financial instrument to which that information relates. Details of such regulation shall be notified to the Commission.

price. On one occasion even he told a client the planned date of publication. Citigroup published the research at 17.40 on 23 January with a buy recommendation at the target price of €39 per share; BI's price at the time was €25.70.⁵⁷⁶

The FSA fined Mr. Casoni on the ground of failing to observe proper standards of market conduct while carrying out his role as an Approved Person. Mr. Casoni's activity amounted to a breach of Principle 3 of the FSA's Statement of Principles for Approved Persons, which states "An approved person must observe proper standards of market conduct in carrying out his controlled function". It is worth noting that the Statements of Principle issued under section 64 of the FSMA 2000 are stated in the FSA's Code of Practice of Approved Persons (APER).⁵⁷⁷ Section 64 of the FSMA 2000 states "The Authority may issue a statement of principle with respect to the conduct expected of approved persons...". An approved person is a person in relation to whom the FSA has given its approval under section 59 of the Act (Approval for particular arrangements) for the performance of a controlled function.

Margaret Cole, FSA Director of Enforcement, indicated that:

...Mr. Casoni failed to observe proper standards of market conduct by deliberately disclosing his valuation methodology, his recommendation and target price to external parties prior to its publication. By doing so Mr. Casoni allowed the recipients the opportunity to pre-empt the conclusions of the published research ahead of the rest of the market.⁵⁷⁸

Control of inside information

As mentioned before, modern securities market regulation recognizes issuers' legitimate interests in delaying disclosure and selective disclosure. Thus, there are situations where an issuer is allowed by the regulations to keep inside information confidential until the proper time for its disclosure. Such situations include the development of a new product, preparation for redundancy, the negotiation of a contract or preparation for a takeover. It is therefore logical to oblige the issuer to control inside information in order to minimize the

⁵⁷⁶ FINANCIAL SERVICES AUTHORITY, Final Notice, *Roberto Chiarion Casoni*, 20 March 2007.

⁵⁷⁷ *ibid.*, p.3.

⁵⁷⁸ FINANCIAL SERVICES AUTHORITY, Press Release, FSA fines analyst for market misconduct, 20 March 2007.

possibility of an unauthorized leak of it. In this regard, the UK⁵⁷⁹ and DIFC⁵⁸⁰ rules are similar.

* Building of rules

In conclusion, the UK rules under the FSA Handbook and the DIFC rules are clear and detailed. In building new rules of timely disclosure for the UAE law we should depend considerably on these two systems.

We explained that insider dealing regulation and disclosure rules have the common object of maintaining an informed market. The more inside information is made public, the less opportunity for insiders to exploit such information. In recent years, the jurisdictions of the US and the UK have rapidly developed more rigid timely disclosure requirements. In the jurisdictions of the US, the UK and the DIFC there is an affirmative duty on issuers to make timely disclosure of any material non-public information.

One conclusion from the comparative study is that the kind of information which must be made the subject of timely disclosure rules is ‘inside information’. Therefore, the definition of ‘inside information’ reached above should also be relevant for the purpose of timely disclosure.

Different terms were used to indicate the time within which an issuer should make the disclosure. We would suggest that the terms ‘quickly’, ‘without delay’ and ‘as soon as possible’ all indicate that an issuer should not take more than the shortest reasonable time necessary for meeting the procedures of disclosure. We prefer using ‘as soon as possible’.

On the basis of the above-mentioned conclusions, we would recommend the following draft rule for reform of the UAE regulation:

⁵⁷⁹ In the UK, the FSA Handbook states:
DTR 2.6.1R

An *issuer* must establish effective arrangements to deny access to *inside information* to *persons* other than those who require it for the exercise of their functions within the *issuer*.

⁵⁸⁰ In the DIFC, the OSR states:

Guidance:

12. Reporting Entities should have a consistent procedure for assessing whether information is Price Sensitive and should clearly identify those within the Reporting Entity who are responsible for the communication of this information to the market.

13. Reporting Entities should put in place arrangements for maintaining the confidentiality of Price Sensitive information before announcement. This should include adequate training for Employees in the handling, distribution and announcement of Price Sensitive information as appropriate. Reporting Entities should guard against the risk of Price Sensitive information seeping into the market domain, through leaked internal briefings or via trade journals for example. Where the Reporting Entity considers that this is likely to occur, an announcement should be made.

An issuer shall make disclosure to the market of any inside information which directly concerns the issuer as soon as possible.

We indicated that the DIFC introduced an extensive list of events in which an issuer is required to disclose information. This idea would be useful if introduced into the UAE jurisdiction, where there are no established customs or precedents. We would recommend that the SCA should provide a similar list of examples to that of the DIFC. We would recommend the following rule:

The SCA shall provide a list of examples in which an issuer is required to disclose information.

The UK and DIFC regulations are similar in relation to fulfilling the following functions; the issuers' responsibility to identify inside information, when to disclose, the holding announcement, and the deployment and control of inside information.

We explained the importance of clearly stating that the issuer is responsible for identifying inside information. The issuer should establish a system to monitor changes which give rise to an obligation of timely disclosure. We would recommend the following rule:

The issuer shall be responsible for continuously monitoring whether changes in the circumstances of the issuer are such that a disclosure obligation has arisen.

The regulations of the UK and the DIFC allow issuers to make a holding announcement where there is an unexpected event and the issuer needs more time to clarify the situation. We would recommend the following rule for reform of the UAE law, which is inspired by both the UK and the DIFC rules:

Where there is an unexpected and significant event, a short delay may be acceptable if it is necessary to clarify the situation. Where there is a danger of information leaking out in the meantime, the issuer should report a holding announcement to the market giving an outline of the subject matter of the announcement.

In the regulations of the US, the UK and the DIFC it is an established principle to exempt an issuer from a disclosure requirement if such disclosure is against the legitimate interests of the issuer. However, there are important issues to be considered in allowing issuers to delay disclosure. We recommend the following draft rule, in which a delay of disclosure is allowed without compromising the public interest:

(1) Where it is reasonably expected that the disclosure required by Article 1 would:
(a) be unduly detrimental to the legitimate interests of the issuer; or

(b) disclose commercially sensitive material, the issuer can apply to the SCA, for non-disclosure and a confidential report of the subject matter, together with written reasons for non-disclosure.

(2) the SCA has the authority either to permit non-disclosure or to require disclosure, taking into consideration that:

- non-disclosure would not be likely to mislead the public;
- disclosure of financial difficulties shall not be delayed;
- the issuer is able to ensure the confidentiality of that information.

We explained the background on which the US has recently introduced new rules to regulate selective disclosure. The same function is fulfilled by the UK and the DIFC regulations. It is acknowledged that in the normal course of business there is usually selective disclosure of information to, for example, a strategic investor. However, the following recommended rule is to ensure that such selective disclosure is regulated:

Whenever an issuer or a person acting on his behalf selectively discloses any inside information to a third party in the normal course of business, the issuer shall make disclosure of that information to the market:

- simultaneously in the case of an intentional disclosure; and
- as soon as possible in the case of a non-intentional disclosure.

An issuer should be obligated to control inside information against any leak. This function is fulfilled by the UK and the DIFC rules. We would recommend the following rule:

An issuer must have in operation procedures or systems to deny access to inside information to persons other than those who are authorised to have access to such information.

Conclusion

The applied study, especially through the qualitative method of interviews, has found that central issues and terminology need to be clarified in order to ensure the clear regulation of insider dealing. These are: insider, inside information, prohibited activities, the scope of financial instruments covered by the regulation of insider dealing, exemptions and Chinese walls.

This chapter is built on the propositions that the earlier chapters highlighted the shortcomings in the regulation of insider dealing in the UAE, and that comparative law is the appropriate method in any reform. This chapter should also be read in the light of Chapter 4, which explains the background to the jurisdictions compared.

This chapter has attempted to compare the specific rules directed to the regulation of insider dealing in the US, the UK and the DIFC. The comparison has discussed in-depth how each jurisdiction responds to the most important of the above-mentioned issues. The functional comparison used resulted in building rules recommended for jurisdiction in the UAE. The building of rules has been through identifying the shortcomings to be avoided in the compared jurisdictions, as well as the advantages to be emphasised. It is on this basis that the author drafted the recommended rules, benefiting directly or indirectly from the experiences of the compared jurisdictions. In respect of the US law, it was concluded that it is not sensible to leave the above-mentioned issues to be determined by case law, notwithstanding that it has paved the way to the introduction of clearer rules in other jurisdictions. A lesson to be learned from the US law is that leaving the regulation to be interpreted by the judiciary is unsuitable, especially for a jurisdiction such as the UAE with no precedents in insider dealing. On the other hand, introducing clearer rules in the UK and the DIFC solves most of the related issues. Nevertheless, we have indicated the advantages and disadvantages of each jurisdiction. The most important criteria on which we made the comparison are clarity of rules, their appropriateness to business and potential difficulties in application.

Under each part of this chapter we introduced recommended draft rules. We also explained how the draft rules represent the results of the comparative study. In the next chapter, the draft rules will be introduced as recommendations for the reform of the UAE law.

Chapter 6: recommendations

Introduction

This chapter contains reasoned recommendations for reform of the UAE law and regulation of insider dealing. These recommendations will be supported by the principal results reached from each of the preceding chapters. They will also be maintained by the sustained findings of the thesis. This is probably because of the realistic and practical approach of the thesis that requires concluding with sound recommendations. In the light of both the applied and comparative legal methods of the thesis, recommendations for UAE regulatory reform would be a productive result for the thesis.

A researcher may have certain ideas before conducting the research. By the end of the research such ideas develop into their final shape. Research is like a factory which receives raw materials and processes them into useable products. It may be considered as a method which supports hypotheses. Such hypotheses can be easily supported if they are logical. The role of the research, then, is not only to supporting hypotheses but also to demonstrate both their strengths and weaknesses.

In fact, this thesis was commenced with limited initial thoughts and hypotheses. However, intensive reading, investigation and analysis has helped to build an organized body of ideas. Thus, the results of this thesis could not be limited to the initial ideas and hypotheses, but rather they contain the whole body of supporting ideas. The effort made in discussing theories, collecting information, comparison and analysis is capable of forming the basis for reasonable results and recommendations.

Although the precise subject of the thesis is the regulation of insider dealing, in practice as well as in theory it is difficult to separate this subject from the wider subject of the regulation of financial markets. What applies to the whole applies to the parts. The precise subject could not be separated from its wider scientific background. Thus, it is apparent that the process of the thesis depended on the generalities of financial market regulation, without escaping from the specialties of the precise subject. Along the same lines, the results and recommendations of the thesis are divided into the general area of financial market regulation and the precise area of insider dealing regulation. The recommendations cannot be separated because financial market regulation constitutes one indivisible unit.

The results and recommendations of the thesis can be divided into the following main areas:

Academic

The thesis raised the question of theorizing about the regulation of insider dealing. An attempt has been made throughout the thesis to build the ideas on a clear line of reasoning. The thesis attempted to adopt a clear approach to the subject, as different readings of the same problem may lead to different results. On this basis, throughout the thesis the main premise has been that insider dealing is against the principle of equal access to information in financial markets. The thesis asserted the proposition that insider dealing is largely a marketplace problem. Insider dealing is therefore a main issue which should be dealt with by financial market regulation in any jurisdiction. The proposition of ‘equal access to the information’ provides a valid ground for the regulation of insider dealing. It is also compatible with the principles of market transparency and the ethical consideration that insider dealing is unfair. It is on this basis that the thesis, adopting this approach, has found its own path. One of the more important results is that the regulation of insider dealing complements disclosure rules.

There are still controversies regarding the justifications behind the regulation of insider dealing. This thesis preferred a pragmatic approach, an approach which is also apparent in most of the jurisdictions of the world. That is, if in practice there is a need to regulate insider dealing, it should be regulated to protect interests such as investors’ rights to equal access of information, transparency of the market and market efficiency. This can be considered one of the results of the thesis.

Another important academic point is in regard to the applied study. It was noted that there was a general lack of research and studies in the UAE in the area of financial markets. It was challenging to conduct an empirical study in an area which had rarely been investigated. The results of the applied study should therefore be read within the limits of time, resources and a lack of earlier studies. Nevertheless, it can be said that the applied study is one step in the right direction. There should be a body of research and studies in the field of financial market regulation. Only this can help in comprehensively understanding the real situation. The thesis therefore recommends that the authorities in the UAE give much more consideration to applied studies in the field of financial market regulation.

Another point which should be given attention is the methodology of the thesis. The thesis has combined an applied study and a comparative legal study. The two different methodologies helped in investigating the real problem and then looking for an appropriate

solution. Academics in the UAE may still not be familiar with combining social science and legal methodology. This thesis recommends adopting socio-legal methodology for any academic work in the field, in order to reach more practical results.

It is also recommended that financial market regulation be introduced as a module in law schools in the UAE. This will ensure more specialists in the field, and consequently more academic contributions.

Reforms to financial regulation in the UAE

It cannot be denied that the UAE (and especially Dubai) has introduced many economic and regulatory reforms to the financial system. The emerging markets of the country need a longer time to absorb the rapid and continuous changes in the financial world. This is not to say, however, that the situation could not be better. There are many fundamental shortfalls which act as barriers to any further reform.

We recommend that the authorities in the UAE establish a commission which specialises in improving the financial regulatory system. The main modus operandi of the commission should be reforming the national legal system. This should be achieved by shedding light on its shortcomings through a comparison with other developed jurisdictions, international standards and best practices.

It is not an overstatement to say that the real difficulty faced by the researcher was examining the background of the comparative systems. It should be an invaluable recommendation, even if the only achievement of the thesis was to enable officials to identify the proper criteria for finding the appropriate jurisdictions from which to benefit. This thesis recommends three such criteria: the general characteristics of the jurisdiction, the main characteristics of the regulatory system and the characteristics of the rules relating to insider dealing.

Chapter 4 of the thesis looked at the US, the UK and the Dubai International Financial Centre (DIFC) explaining the background to and nature of the systems of each. The chapter concluded with important results from the comparative systems.⁵⁸¹ To avoid repetition, the important lessons from the comparative perspective can be summarised as:

- It appears that each jurisdiction has, over a long time, built up a regulatory system that is appropriate to its financial policy. The US has built up its self-regulatory

⁵⁸¹ See above heading: A comparative perspective of the systems of the US, the UK and the DIFC in regulating insider dealing.

system as a result of several decades of experience and precedents. Therefore, this thesis recommends that a self-regulatory system is inappropriate for an inexperienced country like the UAE, where the markets were established as recently as the year 2000.

- The regulator in the UAE is the SCA. This is a statutory body facsimile of the FSA in the UK and the DFSA in the DIFC. It is apparent that the FSA and the DFSA as regulators have clear responsibilities and objectives. In the UK, extensive regulatory powers were transferred to the FSA. One main reason for establishing such a statutory regulatory body was to maintain an orderly and transparent market, and combat financial crime. This included the investigation and prosecution of insider dealing. The thesis recommends that the SCA's responsibilities and objectives should be clear, especially the aforementioned two objectives.
- The DIFC, as a separate jurisdiction, has its own underachievement. There should be co-operation between the DIFC and the financial regulators in the UAE. Providing that one goal of establishing the DIFC is raising the level of regulation in the country, there should be practical steps to achieve this goal; for example, establishing a joint-committee specialised in looking at how the UAE jurisdiction could benefit from the DIFC.
- The recent trend in the regulation of insider dealing is to delegate to the regulator the power to enforce civil/administrative fines to deter insider dealing. This is apparent in the reforms in the UK. It is also apparent in the US system, where combining more than one kind of penalty has been efficient in combating insider dealing. For a long time, the UK system depended on criminal sanctions. These were thought to be a main reason for the limited number of successful prosecutions of insider dealing. Therefore, the UK government adopted a civil/administrative regime through the FSMA 2000 as a more practical weapon to deter insider dealing. The DIFC also has an administrative system to deter market misconduct and insider dealing. It can be said that the current trend in regulation is to establish an empowered administrative system in order to deal with insider dealing and market abuse. The practical reason underlying such a trend is that proof in a civil/administrative case is easier than in a criminal case. It can be observed, especially from the UK experience, that an administrative regime is more efficient than a criminal regime. Therefore, the thesis recommends introducing a

civil/administrative system to deal with insider dealing and other market misconduct. An administrative regime in which the regulator has powers to impose civil penalties on insider dealers is believed to be more practical. Adequate authority should be delegated to the SCA in order to enable it to introduce rules, supervise markets, and investigate and prosecute insider dealing.

- One important lesson of studying insider dealing regulation in the US is the importance of clarity of regulation. The breadth of the antifraud provisions in the US, and the administrative and judicial precedents, have resulted in controversial theories attempting to prohibit insider dealing. The act of insider dealing while in possession of inside information should be accurately defined for more than one reason. One reason is that it is unfair to punish someone under an obscure law. Another reason is that to differentiate between illegal and legal insider dealing which is not on the basis of inside information. Financial regulations are supposed to be clear and detailed because they are dedicated to business. Looking at the regulations at the DIFC and DFSA, it is apparent that there is consideration given to the clarity, detail and guidance. In emergent markets such as those in the UAE, there should be an emphasis on clarity, detail and guidance of regulation, since there are insufficient precedents to serve as proper guidance. Therefore, this thesis recommends that any reform of regulation in the UAE must take into account the clarity and detail of regulation. Bringing detail and sufficient guidance under the rules is essential in order to provide certainty to business.
- The national jurisdiction of any country should give consideration to implementing standards adopted internationally or regionally. Officials in the UAE should decide whether there should be a plan to move financial regulation in the country closer to international standards. The thesis recommends that, regardless of a plan to implement international standards and best practices, the regulation of financial markets in the UAE should be improved to meet the expectations of investors.
- It is important that the law explains why there is a need to regulate insider dealing. One lesson of comparing the UK and the US regulations is that a clear determination of the policy of regulation helps the regulator and the courts to enforce the law benefiting from the clarity of the purpose of the law. This thesis, therefore, recommends that the SCA should introduce a policy underlying the regulation of insider dealing.

Reforms to the SCA in the UAE

The SCA is a modern regulator and its establishment was a great step in reforming the financial system of the UAE. It is undeniable that the SCA has introduced fundamental reforms into the regulation of financial markets. However, our discussion and applied study have articulated that there are certain areas in which there may be underachievement.

One problem which needs to be resolved is determining the authorities and responsibilities of different financial regulators in the UAE. The authorities of the SCA should be clearly determined and distinguished from those of the financial markets. There should be a clear determination of the relationship between the SCA, the Central Bank of Union and the Ministry of Economy. The authorities and responsibilities of each should be clear. In particular, more powers need to be delegated to the SCA.⁵⁸²

There should be amendment of the establishing law which is Federal Law No.4 of 2000 and implementation of Cabinet Resolutions. Redrafting of these laws is essential in order to avoid the apparent repetition of the objectives and powers of the SCA. The Cabinet should introduce detailed regulation to implement Federal Law No.4 of 2000. More powers, such as powers to introduce rules and investigation and enforcement powers, should be clearly delegated to the SCA.

The SCA should develop its own regulatory policies. In particular, this thesis recommends that:

- The SCA should introduce a complete body of regulations. As discussed in Chapter 2, there is a need to detail regulations and guidance. The rules and regulations should be clearly drafted, introducing definitions of the main terms and providing sufficient guidance. The current regulations do not clearly cover all areas of financial services; for example the regulation of funds. There should also be consideration given to cross-sector regulation. For example, merchant banks, in spite of being significant participants in financial markets, are not covered by the regulations of the SCA. In particular, the SCA should utilize its powers to promulgate and enforce regulations. These powers were delegated to the SCA by Federal Law No. 4 of 2000. In the case that such powers are insufficient or the SCA is not clearly empowered, there should be amendments to the aforementioned law to

⁵⁸² See above heading: The law of securities markets in the UAE.

improve the SCA. Officials in the UAE should take into consideration recent developments in other jurisdictions. In the UK, the FSA was established as a regulator with extensive powers to regulate cross-border financial services. Also the DFSA in the DIFC is a modern regulator. It has extensive powers to introduce and enforce regulations.⁵⁸³

- The SCA should clearly determine its goals and the regulatory policies and tools to achieve its goals. In particular, there should be an emphasis on the enforcement tools which the SCA is empowered to use to achieve goals and regulatory policies. The SCA should not be lenient on breaches in the marketplace. In order to maintain orderly markets, it is important to have a regulatory body which has a clear law enforcement policy. The SCA should be stringent and transparent in enforcing the laws and regulations. The applied study supports the assumption that there are concerns about the SCA's efficiency.⁵⁸⁴ The SCA should benefit from the DFSA in the DIFC which, in spite of being recently established, succeeded in gaining international recognition. The success of the DFSA should be an incentive for other regulators to raise the level of regulation closer to international standards.
- The SCA should draft clear rules relating to insider dealing and timely disclosure. It should apply more rigid controls on issuers breaching timely disclosure rules. The SCA should introduce realistic methods of measuring the time issuers take in meeting the obligations of timely disclosure. Issuers' disclosure of their quarterly results should not be appraised as an achievement. The real challenge is in obligating issuers to meet their continuous obligations, especially those of making the timely disclosure of any material non-public information. The mechanism in which the SCA works has not been efficient in separating the markets from the old corrupt situation (where there was no disclosure at all) and adopting a new transparent system. There is no prospect of further development if monopolising and concealing material information from shareholders and investors continues.⁵⁸⁵

⁵⁸³ This is discussed above in-depth. See heading: The regulation of financial markets in the UK, and heading: Structure and regulation at the Dubai International Financial Centre (DIFC).

⁵⁸⁴ See above the discussion under Figure 23.

⁵⁸⁵ See above heading: Shortfall in the enforcement of the timely disclosure and insider dealing regulation.

Reforms to the regulation of insider dealing and timely disclosure

It has been asserted that there should be reforms to the regulatory system as a whole, and to the way in which the SCA functions. Any amendments to the rules would be insufficient if there were no reforms to the wider system.

It is also important that different rules overlap in support of the aspirations underlying financial market regulation. They differ in the roles they play in achieving the goals of the regulatory system. One important result of the thesis is that the timely disclosure of inside information is the main protective tool against insider dealing. The more inside information there is disclosed into the market, the less the chance for insiders to exploit such information.

Some areas may require cross-sector regulation. That is, regulating the same issue in more than one sector (for example, banking, investment banking or stock markets). One important such issue is the Chinese Walls procedure. For such procedures to be effective, they must be implemented in cross-sector regulations.

It should also be noted that the jurisdiction of the UAE is not familiar with some legal concepts considered conventional in other jurisdictions. Timely disclosure may be one of these legal concepts. But the clearest example is the concept of Chinese Walls, which is non-existent in UAE jurisdiction. Therefore, introducing such rules may be considered a primary change. That is not to say that such changes are unattainable. Some of our recommendations represent primary changes, to the jurisdiction in the UAE. However, it is easy to introduce such changes through soft law, if it deemed practical to face insider dealing.

Chapter 5 of this thesis provided a functional comparison between the rules directed to the regulation of insider dealing and timely disclosure in the jurisdictions of the US, the UK and the DIFC. The functional comparison aimed at building up recommended new rules for the UAE law through looking at the advantages and disadvantages of the comparative laws. The ‘function’ of the comparative study was the “building of a system”. The poor drafting of regulations in the UAE has been discussed earlier (in Chapter 2).⁵⁸⁶ The comparative legal study served as a practical method of introducing a better law, which at the same time meets the needs of the national system. Depending on evaluating and criticising the comparative laws in Chapter 5, we can recommend the following draft rules;

⁵⁸⁶ See above headings: Insider dealing regulation in local financial markets in the UAE; and The regulation of timely disclosure in the UAE.

The regulation of insider dealing

Article 1: prohibited activities⁵⁸⁷

Any insider who has inside information shall be prohibited from:

- dealing in related investments on the basis of the inside information;
- disclosing the inside information to another person, otherwise than in the proper course of the exercise of his employment, profession or duties;
- encouraging another person, on the basis of the inside information, to deal in related investments.

Article 2: the definition of an insider⁵⁸⁸

An insider is any natural person who has inside information who:

- is a director, employee or shareholder of an issuer of investments;
- has access to the inside information through the exercise of his employment, profession or duties;
- learned of the inside information by other means and knows or ought reasonably to have known it is inside information.

Article 3: the definition of inside information⁵⁸⁹

(1) Inside information is information which is:

- 1) material;
- 2) non-public.

(2) Information is material if it:

- is precise information which indicates an event or circumstance that has occurred or may reasonably have been expected to occur;
- relates, directly or indirectly, to the investments or to the issuer of the investments;
- would, if generally available, be likely to have a significant effect on the market price or the value of the related investments.

(3) Information is non-public if it is:

- not generally available;
- has not been disclosed in accordance with any laws and regulations applicable in the country.

(4) Information shall be considered public if:

- it is disclosed in accordance with any laws and regulations applicable in the country;
- it is otherwise generally available;
- it is derived by analysing or developing other information which is public.
- it can be obtained by observation.

Article 4: the definition of investments⁵⁹⁰

⁵⁸⁷ Borrowed from or inspired by Markets Law, DIFC Law No.12 of 2004, Sections 42-43. A result of the discussion under heading: Prohibited activities.

⁵⁸⁸ Borrowed from or inspired by the FSMA 2000 Section 118B and Markets Law, DIFC Law No.12 of 2004, Section (45)(2). A result of the discussion under heading: The definition of an 'insider'.

⁵⁸⁹ Borrowed from or inspired by CJA 1993 Section 56, FSMA 2000 Section 118C and Markets Law DIFC Law No.12 of 2004 Section (42) and (45). A result of the discussion under heading: The definition of 'inside information'.

For the purpose of Article 1 ‘investments’ shall be determined by the SCA.⁵⁹¹

Article 5: exemptions

An act which is considered by financial markets’ customs as being in the normal course of business or an accepted market practice shall be exempted from the prohibition in Article 1. The SCA shall provide examples for such accepted acts.

Article 6: corporation’s liability to insider dealing⁵⁹²

A corporation contravenes this part if:

- 1) a natural person acts on behalf of the corporation in contravention of Article 1;
- 2) such natural person discharges managerial responsibilities; and
- 3) the corporation did not have in operation at that time any policies or procedures to ensure that such natural person would not violate Article 1. Such policies and procedures include Chinese Walls.

Article (General): Chinese Walls⁵⁹³

The SCA shall make rules commonly known as ‘Chinese Walls’ rules. The SCA shall determine the arrangements for Chinese Walls, such as procedures, systems, management and physical separation. Firms which have departments with conflicting interests shall employ Chinese Walls in order to ensure that information obtained by one part of a firm is not communicated in inappropriate circumstances to another part of the firm.

The regulation of timely disclosure

Article 1: timely disclosure of inside information⁵⁹⁴

An issuer shall make disclosure to the market of any inside information which directly concerns the issuer as soon as possible.

Article 2: examples⁵⁹⁵

The SCA shall provide a list of examples in which an issuer is required to disclose information.

Article 3: issuer’s responsibility for identifying inside information⁵⁹⁶

⁵⁹⁰ A result of the discussion under heading: The scope of financial instruments covered by the regulation of insider dealing.

⁵⁹¹ We would recommend that in drafting the regulation it seems proper to cover securities, bonds, Islamic bonds, investment units and derivatives on securities. On the other hand, it does not seem appropriate to extend the scope of the regulation to cover derivatives on commodities, interest rates, foreign exchange and other non-securities financial instruments.

⁵⁹² Borrowed from or inspired by Markets Law, DIFC Law No.12 of 2004, Section (49). A result of the discussion under heading: Chinese Walls.

⁵⁹³ Borrowed from or inspired by the FSMA 2000 in “Commentary on Sections” and Markets Law, DIFC Law No.12 of 2004, Section (49). A result of the discussion under heading: Chinese Walls.

⁵⁹⁴ Borrowed from or inspired by the UK rule DTR 2.2.1R of FSA Handbook. A result of the discussion under heading: Timely disclosure of inside information.

⁵⁹⁵ A result of the discussion under heading: Legal uncertainty and providing examples.

⁵⁹⁶ Borrowed from or inspired by the UK rule DTR 2.2.7G of FSA Handbook and the DIFC rule, the OSR, App. 7 Guidance 4. A result of the discussion under heading: Issuer’s responsibility of identifying inside information.

The issuer shall be responsible for continuously monitoring whether changes in the circumstances of the issuer are such that a disclosure obligation has arisen under Article 1.

Article 4: holding announcement⁵⁹⁷

Where there is an unexpected and significant event, a short delay may be acceptable if it is necessary to clarify the situation. Where there is a danger of information leaking out in the meantime, the issuer should report a holding announcement to the market giving an outline of the subject matter of the announcement.

Article 5: delaying disclosure⁵⁹⁸

(1) Where it is reasonably expected that the disclosure required by Article 1 would:

- (a) be unduly detrimental to the legitimate interests of the issuer; or
- (b) disclose commercially sensitive material,

the issuer can apply to the SCA, for non-disclosure and a confidential report of the subject matter, together with written reasons for non-disclosure.

(2) the SCA has the authority either to permit non-disclosure or to require disclosure, taking into consideration that:

- non-disclosure would not be likely to mislead the public;
- disclosure of financial difficulties shall not be delayed;
- the issuer is able to ensure the confidentiality of that information.

Article 6: selective disclosure⁵⁹⁹

Whenever an issuer or a person acting on his behalf selectively discloses any inside information to a third party in the normal course of business, the issuer shall make disclosure of that information to the market:

- simultaneously in the case of an intentional disclosure; and
- as soon as possible in the case of a non-intentional disclosure.

Article 7: control of inside information⁶⁰⁰

An issuer must have in operation procedures or systems to deny access to inside information to persons other than those who are authorised to have access to such information.

* Concluding remark

For the recommended draft rules to function there needs to be a background of an efficient regulatory system. The regulation of insider dealing and timely disclosure should not be read as a remote issue. Thus, reforms to the system should not be limited to amendments to the legal rules. The comparative legal study has discussed in depth the background to each

⁵⁹⁷ Borrowed from or inspired by the UK rule FSA Handbook in DTR 2.2.9G and the OSR, App. 7 Guidance 5. A result of the discussion under heading: Holding announcement.

⁵⁹⁸ Borrowed from or inspired by the UK rule DTR 2.5.1R of FSA Handbook and Markets Law, DIFC Law No.12 of 2004, Article (24). A result of the discussion under heading: Delaying disclosure of information.

⁵⁹⁹ Borrowed from or inspired by the US Rule 100 of RFD, the DIFC, SRO Article 8.2.3 and the UK rule DTR 2.5.6R of FSA Handbook. A result of the discussion under heading: Selective disclosure.

⁶⁰⁰ Borrowed from or inspired by the UK rule DTR 2.6.1R of FSA Handbook and the DIFC, SRO Guidance 12-13.

Control of inside information.

of the comparative jurisdictions before discussing the rules relating to insider dealing. The aim was to emphasise the importance and the influence of the wider system in any regulation. On the other hand, the recommended draft rules are based on the extensive discussion in Chapter 5.

Conclusion

It is appropriate to add concluding remarks with regard to what this thesis has attempted to achieve and how far it has succeeded in doing so. The thesis introduced its own specific topic. It attempted to contribute to the body of knowledge in the regulation of insider dealing. It was necessary that the thesis attempted to be consistent in its approach, methodology and objectives. A proper criterion for assessing the thesis would be to look at the consistency in what we planned and what we actually achieved.

Discussing the limitations of the thesis is a corollary to its evaluation. It is reasonable to critique the limitations of the thesis as well as its strengths. As in any other work, this treatise has been conducted by an individual researcher who has had limited time and financial resources. In regard to the applied study, it would have been invaluable to measure the 'cleanness' of the UAE financial market, and the effects of SCA regulation on the efficiency of the market and share prices. However, such ambitious goals were outside the limits of this work. The applied study should be considered as a limited scale study, though a step in the right direction. With regard to the comparative legal study, it would have been ambitious to look at systems in other countries (such as Arab countries) the systems of which are similar to that of the UAE. However, lack of sufficient academic resources is an obstacle to studying such systems. Also, the systems of these countries have similar shortcomings to that of the UAE. The systems of some Asian countries would have represented ideal models for reform in developing countries. But studying such jurisdictions presents language obstacles. Moreover, the jurisdiction of the DIFC represents a model of best practices around the world, including Hong Kong and Singapore. Another potential limitation could lie in the exclusion of topics related to the regulation of insider dealing. The thesis indicated the powers given to the regulators in different systems to supervise, monitor and investigate insider dealing and other market misconduct. Detailed discussions of such powers and the procedures of supervision and investigation were excluded from this study. Discussions of some practices which are similar to insider dealing such as market abuse were also omitted.

To discuss what the thesis has achieved, an example will be taken from daily life. If any one of us, either individually or through a corporation, is investing an amount of money in a market, either directly or indirectly through an intermediate or a fund, there are priorities which we will consider. We want to receive information regarding the corporation and the

market to which we are directing our money. We do not want such information to be monopolised by those who are inside the corporation. We do not want to be misled by those who manage the corporation. We want our rights to be protected. We do not want someone else to be advantaged over us. We do not want the market to be controlled by criminal activities which benefit certain wrongdoers at the expense of others. This is what has been argued in this thesis. In academic language, it is clear that the protection of the legitimate interests of different market participants is essential to maintaining an orderly and transparent market. The government intervenes in the markets by a system of regulation and a regulatory body empowered to enforce such regulation.

In a developing country with emerging financial markets such as the UAE, there should be continuous evaluation of the regulatory system. This thesis is dedicated to the issue of insider dealing. Some would probably argue that such regulation is not one of the regulatory priorities. However, it can be said that, if seen from the point of view that one function of such regulation is to remove an incentive to delay disclosure, the regulation of insider dealing is a priority. One feature of the informal and unregulated over-the-counter markets in the UAE was the monopoly of information by those inside the corporations. Access to material information was only possible for insiders, their relatives and friends. Introducing formal financial markets and the SCA in the year 2000 was a turning point in the history of financial markets. The formal regulatory system has placed an emphasis on establishing a regulatory framework which ensures the SCA's supervision over markets and brokers in particular. The regulation of securitization, IPOs and listing, and the continuous obligations of issuers can be described as underachieving. Emphasis has been given to basic obligations such as the disclosure of quarterly financial results. The system has shown weakness in regulating insider dealing and other market misconduct. There is hardly any achievement in this regard. It is logical therefore to evaluate the regulatory system and highlight areas of underachievement, one of which is the regulation of insider dealing.

When constructing this thesis, consideration was given to the issues arising during the discussion. Thus, the initial structure was as flexible as possible in order to include any new issue emerging during the discussion. The inclusion or exclusion of related issues depended on their appropriateness to the purposes of the thesis.

The thesis has had its own approach to the problem. To be precise, the rationale for the regulation of insider dealing is that it is against 'equality of information'. This was the

conclusion in Chapter 1, which discussed the policy of the regulation of insider dealing. The second chapter aimed at investigating the history and evolution of financial markets and their current regulatory situation. The third chapter broached the problem of insider dealing in the local markets in the UAE. Through the applied study, the chapter attempted to support the argument that there are regulatory shortcomings in local financial markets. The most obvious of these are shortcomings in transparency, disclosure of information, protection of the market and investors, and regulating insider dealing. Following this, the thesis provided a legal comparison to generate reasonable recommendations for the reform of the UAE system through looking at the advantages and disadvantages of the comparative laws. Chapter 4 provided a 'macro-comparison' approach to the regulation of insider dealing. The discussion of comparative systems in this chapter aimed at exploring the background and the nature of the systems. Chapter 5 provided a comparative legal study, but it had a specific methodology and objectives. This chapter provided a 'micro-comparison' approach to the particular rules relating to insider dealing and related issues. Thus, the core body of the thesis is divided into an applied study and a comparative legal study. The considerations and lessons raised by the academic discussion of the thesis are represented in the recommendations. The overall results of the thesis are designed as recommendations for reform of the UAE regulations. If we were reasonably accurate in our investigation of the shortcomings of the UAE system, and in the comparative study which indicated lessons to be learned, the recommendations will be invaluable.

At the end of the thesis, I should indicate that I spared no effort in conducting this thesis. My personal underlying aims, besides fulfilling submission requirements, were to further my knowledge in the field and to produce a piece of academic writing which would be a substantial contribution to the libraries in the UK and the UAE.

Appendices

Appendix 1: original questionnaire (Arabic)

استبيان.

هذا الاستبيان هو أداة بحث لجمع المعلومات الضرورية لغرض البحث التالي:
العنوان: تنظيم تعامل المطلعين: دراسة في القانون المقارن والدروس المستفادة للقانون الإماراتي، أطروحة لنيل درجة الدكتوراه في القانون.

الباحث: عبدالسلام محمد عمر البلوشي.

المشرف: روبرت دروري.

الجامعة: جامعة إكستر في المملكة المتحدة.

الفترة الزمنية: 2005-2008.

أرجو من المشاركين التجاوب مع الاستبيان حيث أن:

الغرض من الاستبيان هو قياس الآراء لغرض البحث العلمي فقط.

الباحث قد يستخدم هذه الآراء في رسالة الدكتوراه أو في أبحاث أخرى في نفس المجال.

الباحث سيبدل ما في وسعه للحفاظ على المعلومات و استخدامها لغرض البحث العلمي فقط و سيحذف البيانات بعد الإنتهاء من البحث.

المشاركة في البحث اختيارية و المشارك يمتلك الحق في الإنسحاب متى شاء من دون ذكر أية أسباب.

الفقرة (1):

المطلوب من المشارك ترتيب العبارات التالية بالأرقام من (1) إلى (5) و ذلك حسب أهميتها في نظر المشارك، بحيث يكون الرقم (1) للأكثر أهمية و الرقم (5) للأقل أهمية و باقي الأرقام بنفس الترتيب.

يجب أن تتسم أسواق المال بالشفافية و أن يلزم مصدري الأوراق المالية بإفصاح الفوري عن أية معلومات جوهرية غير معلنة.	
يجب أن يترك تنظيم أسواق المال لقوى العرض والطلب دون التدخل التنظيمي أو القانوني.	
يجب ألا يسمح للمطلعين بالتعامل بناء على المعلومة الجوهرية غير المعلنة.	
يجب أن يكون المستثمرين على قدم المساواة و أن تتم حماية حقوقهم.	
يجب أن يتم تطبيق المعايير الدولية في تنظيم الأسواق المالية في الدولة.	

الفقرة (2):

فيما يلي مجموعة من السلبيات الشائعة في الأسواق الناشئة، المطلوب من المشارك أن يختار السلبيات التي يرى أنها تنطبق على الأسواق المالية المحلية في دولة الإمارات العربية المتحدة.

انعدام الشفافية في الأسواق.	
أسعار الأسهم لا تعكس القيمة العادلة.	
مستوى الإفصاح الفوري غير مقبول.	
هناك تفرقة بين المستثمرين.	
المطلعين الذين يستغلون المعلومات غير المعلنة لا يتعرضون لعقوبة.	
ليس هناك تحكّم في تعارض المصالح.	
يمكن التلاعب بالسوق بسهولة من قبل كبار المستثمرين.	
القوانين والأنظمة غير واضحة.	
ليس هناك تعويض مدني للمستثمرين المتضررين.	
هناك تضارب و عدم وضوح بين اختصاصات السلطات الحكومية المختصة بتنظيم السوق.	

الفقرة (3).

المطلوب من المشارك أن يشير إلى اختيار واحد من ضمن الخيارات المتعددة، ومن ثم يكتب أية تعليقات إن وجدت لتأييد وجهة نظره.

(1) هل تعتقد أن تعامل المطلع بناء على المعلومة الجوهرية غير المعلنة يمكن اعتباره غير عادل لباقي المستثمرين الذين هم ليسوا على اطلاع على نفس المعلومة؟

اتفق تماما.	
اتفق.	
لا اتفق ولا اختلف.	
اختلف.	
اختلف تماما.	

تعليق:

(2) هل تعتقد أن لتعامل المطلعين تأثيرات سلبية على الشفافية في أسواق المال؟

اتفق تماما.	
اتفق.	
لا اتفق ولا اختلف.	
اختلف.	
اختلف تماما.	

تعليق:

(3) هل تعتقد أن لتعامل المطلعين تأثيرات سلبية على ثقة المستثمرين في أسواق المال؟

اتفق تماما.	
اتفق.	
لا اتفق ولا اختلف.	
اختلف.	
اختلف تماما.	

تعليق:

(4) هل تعتقد أن لتعامل المطلعين تأثيرات سلبية على الفعالية الإقتصادية لأسواق المال؟

اتفق تماما.	
اتفق.	
لا اتفق ولا اختلف.	
اختلف.	
اختلف تماما.	

تعليق:

(5) هل تعتقد أن لتعامل المطلعين تأثيرات سلبية على اقتصاد الدولة؟

اتفق تماما.	
اتفق.	
لا اتفق ولا اختلف.	
اختلف.	
اختلف تماما.	

تعليق:

(6) هل تعتقد أن لتعامل المطلعين تأثيرات سلبية على جذب السيولة إلى الأسواق المالية؟

اتفق تماما.	
اتفق.	
لا اتفق ولا اختلف.	
اختلف.	
اختلف تماما.	

تعليق:

(7) هل تعتقد أن لتعامل المطلعين تأثيرات سلبية على جذب الإستثمارات الأجنبية إلى الأسواق المالية؟

اتفق تماما.	
اتفق.	
لا اتفق ولا اختلف.	
اختلف.	
اختلف تماما.	

تعليق:

8) هل تعتقد أنه يجب منع تعامل المطلعين بناء على المعلومة الجوهرية غير المعلنة؟

اتفق تماما.	
اتفق.	
لا اتفق ولا اختلف.	
اختلف.	
اختلف تماما.	

تعليق:

9) هل تعتقد أنه بالإمكان منع تعامل المطلعين عن طريق قوانين و أنظمة الأسواق المالية؟

اتفق تماما.	
اتفق.	
لا اتفق ولا اختلف.	
اختلف.	
اختلف تماما.	

تعليق:

10) هل تعتقد أن اتباع المعايير الدولية في تنظيم الأسواق المالية ضروري لرفع مستوى الشفافية في الأسواق المالية؟

اتفق تماما.	
اتفق.	
لا اتفق ولا اختلف.	
اختلف.	
اختلف تماما.	

تعليق:

11) هل تعتقد أن تعامل المطلعين و التلاعب بالسوق هي من ضمن الأسباب التي أدت إلى انهيار سوق الأسهم غير الرسمية في دولة الإمارات العربية المتحدة في صيف العام 1998؟

اتفق تماما.	
اتفق.	
لا اتفق ولا اختلف.	
اختلف.	
اختلف تماما.	

تعليق:

12) هل تعتقد أن تعامل المطلعين و التلاعب بالسوق هي من ضمن الأسباب التي أدت إلى ظهور فقاعة في أسعار الأسهم في الأسواق المالية المحلية في دولة الإمارات العربية المتحدة في العام 2005 و من ثم التصحيح الحاد في العام 2006؟

اتفق تماما.	
اتفق.	
لا اتفق ولا اختلف.	
اختلف.	
اختلف تماما.	

تعليق:

13) هل تعتقد أن قوانين و أنظمة الأسواق المالية المحلية في دولة الإمارات العربية المتحدة المطبقة حاليا مجدية لمنع تدهور أسواق المال في المستقبل؟

اتفق تماما.	
اتفق.	
لا اتفق ولا اختلف.	
اختلف.	
اختلف تماما.	

تعليق:

14) هل تعتقد أن هناك حماية لحقوق المستثمرين في الأسواق المالية المحلية في دولة الإمارات العربية المتحدة؟

اتفق تماما.	
اتفق.	
لا اتفق ولا اختلف.	
اختلف.	
اختلف تماما.	

تعليق:

15) هل تعتقد أنه يجب رفع مستوى الشفافية و الإفصاح في الأسواق المالية المحلية في دولة الإمارات العربية المتحدة؟

اتفق تماما.	
-------------	--

اتفق.
لا اتفق ولا اختلف.
اختلف.
اختلف تماما.

تعليق:.....
 (16) هل تعتقد أن القانون الحالي لمنع تعامل المطلعين في الأسواق المالية المحلية في دولة الإمارات العربية المتحدة واضح ودقيق؟

اتفق تماما.
اتفق.
لا اتفق ولا اختلف.
اختلف.
اختلف تماما.

تعليق:.....
 (17) هل تعتقد أن القانون الحالي لمنع تعامل المطلعين في الأسواق المالية المحلية في دولة الإمارات العربية المتحدة مطبق بشكل فعال من قبل السلطات الحكومية المختصة؟

اتفق تماما.
اتفق.
لا اتفق ولا اختلف.
اختلف.
اختلف تماما.

تعليق:.....
 (18) هل تعتقد أنه بالإمكان منع تعامل المطلعين عن طريق رفع مستوى الشفافية و الإفصاح في أنظمة أسواق المال المحلية في دولة الإمارات العربية المتحدة؟

اتفق تماما.
اتفق.
لا اتفق ولا اختلف.
اختلف.
اختلف تماما.

تعليق:.....
 (19) هل تعتقد أن المحاكمة و العقوبة الجنائية فعالة في منع تعامل المطلعين في أسواق المال المحلية في دولة الإمارات العربية المتحدة؟

اتفق تماما.
اتفق.
لا اتفق ولا اختلف.
اختلف.
اختلف تماما.

تعليق:.....
 (20) هل تعتقد أن تفيوض هيئة الأوراق المالية والسلع بتطبيق غرامة مالية من دون محاكمة جنائية سيكون أكثر فعالية في ردع التلاعب بالسوق و تعامل المطلعين؟

اتفق تماما.
اتفق.
لا اتفق ولا اختلف.
اختلف.
اختلف تماما.

تعليق:.....

Appendix 2: translation of the questionnaire (English)

Questionnaire.

This questionnaire is a method to collect necessary data for the following research:

Title: The Regulation of Insider Dealing: A Comparative Legal Study Towards Recommendations for the UAE Law. (PhD Thesis).

Researcher: Mr. Abdulsalam Albelooshi.

Supervisor: Mr. Robert Drury.

University: University of Exeter, the United Kingdom.

I ask for your participation, since;

The questionnaire aims to measure attitudes only for the purpose of research.

All the information provided by you in the interview will be used for research purposes and will be secured in the privacy of the researcher's home office and that any audio tapes of my conversations with the researcher will be erased following the end of the research.

Your participation in this study is, of course, voluntary. You have the right to choose not to participate or to withdraw from the study at any time without giving any reasons.

Section (1):

The respondent is asked to rank 5 principles of financial market regulation in order of importance. They are to give 1 as the most important principle, 2 as the next most important principle, and so on.

	Financial markets should be transparent and issuers should make timely disclosure of any inside information.
	Financial markets should be controlled only by economic factors, not by regulations.
	Insiders should not be allowed to use inside information for their own benefit.
	Investors in financial markets should be put on an equal footing and their rights should be protected.
	There should be an implementation of international standards of regulation in the local financial markets of any country.

Section (2):

The respondent is asked to select from ten negative aspects of financial markets which they thought were applicable to the local markets in the UAE.

	The market is not transparent.
	Share prices do not reflect the true value.
	The level of timely disclosure is inappropriate.
	There is prejudice between investors.
	Insiders are not punished for insider dealing.
	Conflict of interests is uncontrolled.
	The market can be easily abused by bigger portfolio investors.
	The laws and regulations are not clear.
	There is no civil remedy for plaintiff investors.
	There is uncertainty and conflict between the powers of the different authorities regulating financial markets.

Section (3):

The respondent is asked to choose one amongst multiple choices. Then she/he may provide any further comments supporting his/her choice or presenting further opinion.

1) Do you think that insider dealing is unfair to other investors who do not have access to inside information?

	Strongly agree.
	Agree.
	Neither agree nor disagree.
	Disagree.
	Strongly disagree.

Comments:.....

2) Do you think that insider dealing has negative effects on transparency in financial markets?

	Strongly agree.
	Agree.
	Neither agree nor disagree.
	Disagree.
	Strongly disagree.

Comments:.....

3) Do you think that insider dealing has negative effects on investor confidence in financial markets?

	Strongly agree.
	Agree.
	Neither agree nor disagree.
	Disagree.
	Strongly disagree.

Comments:.....

4) Do you think that insider dealing has negative effects on the economic efficiency of financial markets?

	Strongly agree.
	Agree.
	Neither agree nor disagree.
	Disagree.
	Strongly disagree.

Comments:.....

5) Do you think that insider dealing has negative effects on the economy of the country?

	Strongly agree.
	Agree.
	Neither agree nor disagree.
	Disagree.
	Strongly disagree.

Comments:.....

6) Do you think that insider dealing has negative effects on attracting liquidity into the financial markets?

	Strongly agree.
	Agree.
	Neither agree nor disagree.
	Disagree.
	Strongly disagree.

Comments:.....

7) Do you think that insider dealing has negative effects on attracting foreign investment into the financial markets?

	Strongly agree.
	Agree.
	Neither agree nor disagree.
	Disagree.
	Strongly disagree.

Comments:.....

8) Do you think that insider dealing should be prohibited?

	Strongly agree.
	Agree.
	Neither agree nor disagree.
	Disagree.
	Strongly disagree.

Comments:.....

9) Do you think that the problem of insider dealing can be dealt with by financial market regulation?

	Strongly agree.
	Agree.
	Neither agree nor disagree.
	Disagree.
	Strongly disagree.

Comments:.....

10) Do you think that adopting international regulatory standards is necessary to advance the transparency of the local financial markets in the UAE?

	Strongly agree.
	Agree.
	Neither agree nor disagree.
	Disagree.
	Strongly disagree.

Comments:.....

11) Do you think that insider dealing and other market abuse contributed to market deterioration in the summer of 1998 in the UAE unofficial securities market?

	Strongly agree.
	Agree.
	Neither agree nor disagree.
	Disagree.
	Strongly disagree.

Comments:.....

12) Do you think that insider dealing and other market abuse contributed to the bubble in 2005 followed by the sharp correction in 2006 in the local financial markets in the UAE?

	Strongly agree.
	Agree.
	Neither agree nor disagree.
	Disagree.
	Strongly disagree.

Comments:.....

13) Do you think that the current regulation is sufficient to avoid further deterioration in the local financial markets in the UAE?

	Strongly agree.
	Agree.
	Neither agree nor disagree.
	Disagree.
	Strongly disagree.

Comments:.....

14) Do you think that the investors' rights are protected in the local financial markets in the UAE?

	Strongly agree.
	Agree.
	Neither agree nor disagree.
	Disagree.
	Strongly disagree.

Comments:.....

15) Do you think that transparency and disclosure should be developed in the local financial markets in the UAE?

	Strongly agree.
	Agree.
	Neither agree nor disagree.

	Disagree.
	Strongly disagree.

Comments:.....

16) Do you think that the current law prohibiting insider dealing in the local financial markets in the UAE is clear?

	Strongly agree.
	Agree.
	Neither agree nor disagree.
	Disagree.
	Strongly disagree.

Comments:.....

17) Do you think that the current law prohibiting insider dealing in the local financial markets in the UAE is practically enforced by the authorities?

	Strongly agree.
	Agree.
	Neither agree nor disagree.
	Disagree.
	Strongly disagree.

Comments:.....

18) Do you think that insider dealing can be prevented by raising the level of transparency and disclosure in the regulations?

	Strongly agree.
	Agree.
	Neither agree nor disagree.
	Disagree.
	Strongly disagree.

Comments:.....

19) Do you think that a criminal trial and punishment is effective in deterring insider dealing?

	Strongly agree.
	Agree.
	Neither agree nor disagree.
	Disagree.
	Strongly disagree.

Comments:.....

20) Do you think that fines administered by the Securities and Commodities Authority would be more of a deterrent to insider dealing than a criminal punishment?

	Strongly agree.
	Agree.
	Neither agree nor disagree.
	Disagree.
	Strongly disagree.

Comments:.....

Appendix 3: original letter of consent (Arabic)

بسم الله الرحمن الرحيم

التاريخ/

الموضوع: رسالة لأخذ موافقة مشارك في البحث.

السيد/..... (المحترم).

السلام عليكم ورحمة الله وبركاته،

أما بعد:

فإني أتوجه لك بجزيل الشكر على موافقتك المبدئية للمشاركة في المقابلات التي أجريها لغرض البحث، حيث إن مشاركتك تدل على مدى وعيك واهتمامك بالبحث العلمي وأهدافه.

أنا طالب دكتوراه مبتعث من قبل حكومة دبي، وملتحق بكلية القانون بجامعة اكستر في المملكة المتحدة، والمشرف على البحث هو السيد/ روبرت دروري.

أرجو أن تكون على اطلاع بملخص البحث المرفق بهذه الرسالة والذي يبرز الخطوط العريضة لخطة البحث وبالتالي لتكون على اطلاع بمدى أهمية مشاركتك وإثرائك للبحث، وبهذا الصدد أشير إلى أن البحث يدور حول موضوع "تعامل المطلعين" 'insider dealing' من منظور "القانون المقارن" يقدمه الباحث كأطروحة لنيل درجة الدكتوراه في القانون من جامعة اكستر في المملكة المتحدة.

مرفق بالرسالة أيضاً رسالة من المشرف على البحث السيد/ روبرت دروري من الهيئة التدريسية بكلية القانون بجامعة اكستر في المملكة المتحدة، وذلك لإثبات جدية الباحث ومسؤوليته في جمع المعلومات الضرورية للبحث.

وبهذا الخصوص فأني أؤكد لكم إنني سأكون مراعيًا لجميع أخلاقيات البحث المتعارف عليها في إجراء المقابلات، إن مشاركتك في البحث ستكون عن طريق إبداء أرائك المستندة على خبرتك وإطلاعك في المجال، ومن المتوقع أن تمتد المقابلة حوالي نصف ساعة، وأؤكد كذلك أنه من حَقك عدم المشاركة في المقابلة أو الانسحاب في أي وقت قبل انتهاء المقابلة من دون إبداء أية أسباب، نتائج المقابلة قد تكون محل نشر في رسالة الدكتوراه ولكن لن يتم التطرق لشخصيتك إلا إذا وافقت على ذلك، كما إنني أؤكد أن جميع الآراء التي ستروني بها ستستخدم لغرض البحث فقط ولن يتم تسريبها لأية جهة أخرى، ولن يتم ذكر اسمك أو الإقتباس من أقوالك إلا بعد أخذ موافقتك بذلك، كما أنني أُرغب في الحصول على موافقتك لتسجيل المقابلة صوتياً مما يوفر الوقت والجهد للطرفين و في حال ممانعتك للتسجيل الصوتي فإنني اضطر لكتابة المقابلة كاملة، وبإمكانك تغيير أو حذف أية أقوال عند المراجعة بعد الإنهاء من المقابلة، أشير أيضاً إلى أن الأوراق و الملفات الإلكترونية للمقابلة ستكون بحوزتي مع التزامي بالإحتفاظ بها بنفس درجة السرية التي احتفظ بها بباقي ملفات البحث، وأنه سيتم التخلص من هذه الملفات بعد انتهاء البحث، إن المقابلات تهدف إلى جمع آراء الخبراء في المجال بطريقة مشروعة مستفيدين من تجربتكم وخبرتكم في هذا المجال وليس الإطلاع على أسرار العمل، ولذلك فأني أشير إلى ضرورة التأكد من أن نظام الجهة التي تتبع لها يسمح لك بإجراء هذه المقابلة، مع الإشارة إلى أنه من غير المتوقع أن تتعرض لأية خطورة في حال مشاركتك في البحث سواء من الناحية السياسية أو القانونية أو الإقتصادية، و المقابلة لن تتضمن أية اسئلة شخصية أو اسئلة تتعلق بالجهة التي تنتمي إليها إلا فيما يتعلق بالمعلومات المتوافرة لعامة الناس.

وبهذا الصدد، فأني أود الحصول على موافقتك على جزء أو كل ما يلي:

- أنا اعلم الغرض من البحث وعلى اصطلاح بملخص البحث وبأهمية دوري و مشاركتي في البحث.
- لا أمانع من ذكر اسمي ووظيفتي في البحث.
- أنا اعلم أن الباحث قد يقتبس من أرائي في المقابلة، و قد يستخدم هذه الآراء في رسالة الدكتوراه أو في أبحاث أخرى في نفس المجال.
- أنا اعلم أن الباحث سيبذل ما في وسعه للحفاظ على المعلومات و استخدامها لغرض البحث فقط، وأنه سيمسح البيانات بعد الإنتهاء من البحث.
- أنا اعلم أن مشاركتي في البحث اختيارية و أنني امتلك الحق في الإنسحاب متى شئت من دون ذكر أية أسباب.

وتقبل مني فائق الإحترام و التقدير.

السيد/ عبد السلام محمد البلوشي.

Appendix 4: translation of letter of consent (English)

Letter of Consent.

Dear.....

I am a PhD student at the School of Law, University of Exeter, United Kingdom under the supervision of Mr. Robert Drury. I am conducting research to fulfil the requirements for obtaining a PhD in law and am sponsored by the Government of Dubai.

A letter from my supervisor, Mr Robert Drury from the School of Law, University of Exeter, is also enclosed to verify my accountability and reliability.

I would like you to examine the enclosed summary of the study. It is concerned with the subject of 'Insider Dealing' from a 'comparative legal' approach and is entitled "The Regulation of Insider Dealing: A Comparative Study towards Recommendations for the UAE Law". The summary aims to provide an overall insight into the study and highlights the role and importance of your participation.

In this respect, I would like to ask your permission to conduct an interview with you. I assure you this would be conducted under strict ethical research principles. In the interview (which would be expected to take approximately half an hour) you may wish to provide opinions based on your expertise and insight.

Your participation in this study is, of course, voluntary. You have the right to choose not to participate or to withdraw from the study at any time without giving any reasons. The results of the research study may be published, but your name will not be used unless you consent. I give you my assurance that all the information provided by you in the interview will be used for research purposes, without conveying it to any third party. It would save both time and effort for us both if the interview could be tape or digital recorded. Otherwise, I will have to transcribe it. Following the interview, you will be given the opportunity to review the transcripts or recordings and you may ask for alterations to and omissions from your statement. The transcripts will be kept in the privacy of the researcher's home office and any audio materials containing conversations with the researcher will be erased following completion of the research. Your identity and quotations from the interview will only be mentioned in the research if you give your permission. Each interview will be identifiable only by a random number, and the link between this number and the identity of the interviewee will be kept only in a confidential file in the possession of the researcher and will not be disclosed. The interviewing aims to generate accessible information from your insights and experience, not to access confidential information illegitimately. I would be grateful if you would confirm that your organisation will allow you to take part in the interview. If you agree to participate in this study, there are no foreseeable political, legal or economic risks or discomforts. The interview will not involve any self-incrimination or disclosure of confidential information regarding yourself or the entity to which you belong. In this regard, you have the right to consent or not to any of the following. Please tick all of the following boxes to which you agree and leave those to which you do not agree.

- I understand the purpose of the research being conducted as I have an overview of the study and the role of my participation.
- I agree to be identified in the research by name and position.
- I understand that excerpts from my written transcripts and tape-recorded verbal communications with the researcher will be studied and may be quoted in a PhD thesis and in future papers, journal articles and books that will be written by the researcher.
- I understand that transcripts on paper, and tape recordings and digital files, will be secured in the privacy of the researcher's home office and that any audio tapes of my conversations with the researcher will be erased following the end of the research.
- I understand that my participation is entirely voluntary, and that I may withdraw my permission to participate in this study without explanation at any point up to and including the interview.

Yours.....,

Appendix 5: questionnaire numerical scores

Section (1):

The respondent is asked to rank 5 principles of financial market regulation in order of importance. They are to give 1 as the most important principle, 2 as the next most important principle, and so on.

	Total numerical score.	Rank
1- Financial markets should be transparent and issuers should make timely disclosure of any inside information.	336	1
2- Financial markets should be controlled only by economic factors, not by regulations.	543	5
3- Insiders should not be allowed to use inside information for their own benefit.	519	4
4- Investors in financial markets should be put on an equal footing and their rights should be protected.	387	2
5- There should be an implementation of international standards of regulation in the local financial markets of any country.	420	3

Section (2):

The respondent is asked to select from ten negative aspects of financial markets which they thought were applicable to the local markets in the UAE.

Negative aspects
1- The market is not transparent.
2- Share prices do not reflect the true value.
3- The level of timely disclosure is inappropriate.
4- There is prejudice between investors.
5- Insiders are not punished for insider dealing.
6- Conflict of interests is uncontrolled.
7- The market can be easily abused by bigger portfolio investors.
8- The laws and regulations are not clear.
9- There is no civil remedy for plaintiff investors.
10- There is uncertainty and conflict between the powers of the authorities regulating financial markets.

Negative aspects number	Numerical score	Total number of respondents	Percentage of the negative aspect to other negative aspects
1	111	156	13%
2	117	156	13%
3	84	156	9%
4	63	156	7%
5	111	156	13%
6	45	156	5%
7	138	156	16%
8	57	156	6%
9	96	156	11%
10	66	156	7%

Section (3):

The respondent is asked to choose one amongst multiple choices. Then she/he may provide any further comments supporting his/her choice or presenting further opinion.

Question number	(Strongly disagree) Numerical score	(Disagree) Numerical score	(Neither agree or disagree) Numerical score	(Agree) Numerical score	(Strongly agree) Numerical score
1		6	6	51	87
2		3	18	54	78
3	6	6	9	72	60
4	6	9	42	51	45
5	9	15	42	45	42
6	3	15	24	66	45
7		6	39	51	57
8		18	15	63	54
9	3	18	18	45	69
10			6	54	93
11	6	9	27	30	78
12		15	18	66	54
13	15	45	42	39	12
14	21	60	36	21	15
15			3	45	102
16	9	51	45	45	3
17	3	51	54	30	15
18		6	21	87	39
19		18	27	78	30
20	18	24	18	45	48

Question number	Total numerical score	Non-respondent numerical score
1	150	6
2	153	3
3	153	3
4	153	3
5	153	3
6	153	3
7	153	3
8	150	6
9	153	3
10	153	3
11	150	6
12	153	3
13	153	3
14	153	3
15	150	6
16	153	3
17	153	3
18	153	3
19	153	3
20	153	3

Appendix 6: interviews transcripts

Interview (1)

Transcript translated from Arabic.

Interviewee: Abdullah Al Yabhoni, Listed Companies Department, Head Section, Listing and Compliance, Abu Dhabi Securities Market.

Place and date: Abu Dhabi, August 2007.

INTERVIEWER: What problems do you have in disclosure?

INTERVIEWEE: I will give you an example, press releases. You know that journalists seek for exclusive news about companies. The same is right with international news e.g. Reuters. When a board of a company meets to discuss an upcoming project, they cannot disclose it prior to approval as finalised reliable information. It is like a ship with thousands of people on board. The captain cannot announce his next stop, unless he is in no doubt of his decision. Journalists find insignificant information regarding a company. We contact the company to scrutinize and they tell us that this is an unapproved future project. They say that it is a piece of news and not official press release. This insignificant information is inefficient.

We have our own way in surveillance of member of boards of companies. We watch their dealings. We also see if there is a question mark delay in disclosure from any company.

If you have a look on corporate governance, the way it was initiated in Europe and was transferred to the US. Enhancing transparency and disclosure was the main principle. Corporate governance obligates public companies to disclose all the available information as soon as possible.

The most important people as insiders are member of the board of directors. Then comes the executives and the financial, administrative and operations directors. These are the key factors who we consider as insiders. The others like the office boy have nothing to do with insiders. You cannot put five thousands employees in a company as insiders. You cannot watch all of them. If you want to watch keep a list of those who receive the information first. Major people like financial, executive, operations and factory directors.

INTERVIEWER: Do you have a problem with selective disclosure or the way insiders deal with the press?

INTERVIEWEE: In this point, if there is trivial news does not affect the company, like Aldar PLC announced completion of stage one in a project. This is not important information, it only means that they will begin the next stage of the project. Even if a member of the board, an executive or a financial director announces this, we do not pay attention to it. This is not important for the investor. For investor it is important to know about a strategic joint venture, profits and losses or major project, not a project that is in progress. For example, if a company announces a real state project, the investor wants to know its price, not the type of lighting or roads. Investors do not care about trivial information.

The information has to be material. We do not evaluate information in the press. We are concerned with information that has effects on the price of the securities. For example, if an issuers securities book value is 10 DHS and the company is thinking to split the security. In similar circumstances, the board of directors has to meet and they have to compliant with our regulations. We introduced a 3 step rule for a press release. First, the board has to send us a report and the schedule of the meeting and we make it originally public. If the board meeting was simultaneous with trading time, we bring trading on the security to a halt. Second, following the meeting, both the proposed and the approved schedule along with the approved decisions has to send to us. In turn, we scan all the documents, publish it on the internet and send it to other branches and brokers. It is useful to compare between the proposed and the approved schedules. We can find in there is any difference or anything is deleted. The same procedure is applied when there is a general meeting. They have to notify us of the proposed date and schedule. Following that they have to notify us of the approved decisions.

We have a watch system for all companies and their board of directors. When members of board of directors and other executives deal in the securities of their own company, they have to take our permission. They have to send a request which will be checked by the Market Control Department. In the department they verify his personality and his company. The important thing that the department verifies the company's status in terms of its financial statements or any obligations pending. In case of any incompliance we refuse to give permission to dealing. The checking does not take a long time.

Shareholders of more than 5% do not have to seek permission to deal. However, they dealings appear on the system, because such dealing are important. There dealings represent important information. If someone buys more than 5%, it means that he is confident about the company's status and earnings.

A permission is required only if a member of the board of directors deal in the securities of his own company. There should be a question mark. Why is he buying? Why is he selling? Take the worst scenario, a company might be insolvent, the insider sells all his securities and other shareholders lose the next day.

We should work for narrowing the gap of information between board of directors and other investors. Information hold by the board should reach the investor as soon as possible. This is not an easy task.

INTERVIEWER: What about timely disclosure?

INTERVIEWEE: In the new website, all the disclosures and insiders appear. Any news reaches us will be published on the internet. When an insider deals, we anonymously publish it. 'Insider dealing- buy or sale-volume- number of securities', all that appears as a sticker on the website. This website is under construction and when finished will be open to public.

Interview (2)

Transcript translated from Arabic.

Interviewee: Mithkal Obaidat, Legal Advisor, Abu Dhabi Securities Market.

Place and date: Abu Dhabi, August 2007.

INTERVIEWER: At the beginning, I am not sure who is responsible for applying the rules of insider dealing, is it the Securities and Commodities Authority or the financial markets themselves.

INTERVIEWEE: In regards to responsibility it is shared. If you have a look on the legal rules regulating insider dealing in the Federal Law No.4, it gives authority to the SCA. It means that the SCA regulates insider dealing. Now the SCA watches all the dealings in the financial markets and the same is done by the markets themselves. Suppose that Abu Dhabi Securities Market or Dubai Financial Market suspected of an activity to be insider dealing, its role is limited by reporting the case to the SCA. The SCA in turn completes the investigation alone or in corporation with the market. The SCA has the authority investigate and it has the authority to apply administrative penalties.

There are two Articles which regulates insider dealing in the Federal Law No.4, namely Articles (37) and (39). Article (37) states..... Article (39) states.....

In regards to the punishment, it varies from an administrative punishment to a criminal punishment. The SCA decides whether it gives a warning, imposes a fine up to 100,000 DHS. It can also withdraw the permission of an accountable broker. In addition, they can halt trading in the accountable company's securities. In terms of the criminal punishment, Article (41) states that.....

INTERVIEWER: When I study these Articles, it is helpful to know where they come from. Are they adopted from another country's law?

INTERVIEWEE: I do not know the source of these Articles. I have an insight in the Jordanian and Egyptian laws, and I can say they are not the source of these Articles. Probably the best countries in financial regulation in Arab World are Jordan, Egypt and Kuwait.

INTERVIEWER: The reason I asked this question is that I think there is confusion between two systems, which are self-regulation and statutory regulator. Do you agree with me that Abu Dhabi and Dubai markets still have extensive authorities over listing and disclosure?

INTERVIEWEE: I agree. In UAE law there is a great overlap between the responsibilities of the SCA and the markets. This issue needs to be radically resolved by a federal law, which should segregate between the role of the SCA and that of the markets. In listing, if the SCA adopted its own requirements for listing a security, what is the role of the markets in listing? The same is right with the rules of dealing. Regulators are supposed to have a supervisory role, while markets are supposed to have an executive role. This does not mean that the markets have no supervisory role, since dealings take place in the market and should be watched. The markets should have the authority to issue soft rules. But in the UAE the markets issued rules photocopied from the SCA rules. Thus, there is duplication in the market rules.

INTERVIEWER: There is overlap in responsibilities.

INTERVIEWEE: Yes, there is overlap, and this is known by the SCA and the markets.

INTERVIEWER: What can be a proposed solution?

INTERVIEWEE: A solution can be through a proposed federal law which should clearly segregate between the role of the SCA and that of markets. If we cannot do this, we can adopt a memorandum of understanding which distinguishes the responsibilities and authorities. From a legal point of view the last solution is partial. A memorandum has no power equivalent to the law in front of a court. From my point of view, their should be an amendment to the federal law in this regard.

INTERVIEWER: Do you think that more authorities should be delegated to the SCA or to the markets?

INTERVIEWEE: In the areas of listing and dealing which are the specialities of the markets, the authority to regulate should be delegated to the market. Except rules adopted by the SCA and applicable to the whole country. Such general rules can support fair play between the markets. The regulatory and supervisory role should be in the hand of the SCA which also should be efficient. An efficient regulator means efficient markets.

INTERVIEWER: Is the SCA efficient at the present?

INTERVIEWEE: No, I honestly tell you and record it.

INTERVIEWER: One problem is that we have little experience in these issues.

INTERVIEWEE: Yes, in the UAE we have only seven years experience. There is also a draft law which can resolve these issues. There is a vast area in the financial markets needs to be regulated.

INTERVIEWER: I have some comments on the Articles regulating insider dealing. There is no definition for 'Inside information'.

INTERVIEWEE: A definition is essential, because it determines everything else. There is no definition of inside information...

INTERVIEWER: There is also more than one term used. 'inside information' and 'non-public information'.

INTERVIEWEE: Yes, that is right, it is problematic. Taken simply, the information should be non-public and can affect the price of the issuers' securities if disclosed. These are the two main conditions.

Also the Article states: "a person may not deal on the basis of non-public information...". If someone discloses the non-public information and does not deal on the basis of inside information, he will not be accountable under this Article. This is not unacceptable.

If we required "achieving a benefit for himself or for another" as a condition to accountability. If someone receives the information from an inside source and then discloses it to a third party is also not accountable under this Article. The law should hold accountable those who discloses the inside information and those who act for the benefit of others.

INTERVIEWER: There is also no definition of the 'insider'.

INTERVIEWEE: Yes, there should be a definition of the 'insider', 'inside information' and 'prohibited activities'. There should also be guidance under the adopted definitions.

INTERVIEWER: When can information be considered public?

INTERVIEWEE: When it is disclosed in accordance with disclosure rules. It depends on the rules applicable in any country. In some jurisdictions it is sufficient to disclose the information to the regulator or to the markets. In other jurisdictions it is necessary that the information reaches the public either through the media, the press or the internet.

INTERVIEWER: Who should be considered an insider?

INTERVIEWEE: Any one who possesses inside information due to his status. If someone is an accountant he may possess inside information which is not known to his financial director, general director and board of directors. There is other information which is possessed by the top of the hierarchy, but not for the bottom. The insider is who possesses information due to his status or profession and this is different than the dealer on the basis of inside information. The external financial auditor and the legal advisor can also possess inside information. Contractors with the issuer may sign a non-disclosure agreement because they may have an insight on inside information. These points are not made clear in the UAE law.

INTERVIEWER: Is the criminal punishment appropriate?

INTERVIEWEE: Yes, imprisonment from 3 months to 3 years and fine from 100,000 to 1,000,000 DHS. I disagree with fine of this kind. I agree with the minimum fine, but there should be no maximum fine. I would prefer that the fine be double the profit made or the lost avoided by the insider. If someone made a profit of 20 million and was fined 1 million, he would not be deterred.

INTERVIEWER: It is difficult to prove insider dealing in front of a criminal court. So, is a criminal punishment efficient?

INTERVIEWEE: The problem is that there are no specialized courts in commercial or economic cases. In some countries there are specialized courts in securities.

INTERVIEWER: The case of market abuse in Dubai Islamic Bank securities collapsed, is that because it is difficult to be proved?

INTERVIEWEE: The case of market abuse is different than insider dealing. The case was of artificial dealings to affect the price of a security. The problem in this case was in the lack expert witnesses. The court of first instance in Dubai found the accused guilty without referring the case to an expert committee. In the court of appeal the case was referred to an expert committee. The committee's opinion was that the accused did not violate the law and the court acquitted them.

It is difficult to prove a case of insider dealing. Dealers use various accounts and names. If a member of the board of directors possessed inside information, it is very unusual that he will use the information to deal in securities, it is more probable that he will pass the information to a friend.

INTERVIEWER: There are administrative penalties in some countries to deter insider dealing.

INTERVIEWEE: Yes, this depends on the decision of the SCA. It can impose a fine. However, from my point of view, insider dealing should be criminalised. It causes immense harm to the economy and the investors. It also causes harm to the reputation of the market and the country.

A proposed administrative penalty should be harsh enough to deter insider dealing. A fine should be multiple of the profit made or the lost avoided in order deterring insider dealing.

INTERVIEWER: Do you think that the international standards are implemented in the UAE regulations?

INTERVIEWEE: In general it can be said that the international standards are implemented. However, we need to have more precise regulations and more efficient enforcement. There are many developed countries from which experience we can benefit. There are also international organizations like the IOSCO which provides a lot of details through working papers, rules and principles.

INTERVIEWER: Do you think that we have shortcoming in disclosure?

INTERVIEWEE: Disclosure can be through the market, the SCA and the press. But in reality we consider disclosure to the market or the press makes the information public and so it cannot longer be considered inside information. In the market when we receive the information we convey it to the press, the investors and brokers. Considering the timing of disclosure, it is clear when an issuer discloses the information, but it can be unclear when the issuer has known of the information. An issuer has to disclose inside information as soon as possible. However, in reality there is a period of time between the moment when the issuer knew the information and the moment it disclosed it. This period is critical to insider dealing. Such period of time cannot be identified without investigation.

INTERVIEWER: Are there any rules regulating selective disclosure?

INTERVIEWEE: In application any person dealing with a company signs a non-disclosure agreement. An auditor is obligated by auditing laws not to disclose any information of a client company. Insiders are not only those who work for the issuer but also who has a connection to the issuer.

Interview (3)

Transcript translated from Arabic.

Interviewee: TOJAN AL SHURIDEH, Legal Consultant, Securities and Commodities Authority.

Place and date: Abu Dhabi, August 2007.

INTERVIEWER: If you would like to speak without interfering.

INTERVIEWEE: Looking at your proposal, you looking at the subject from several angles. We can start speaking about the policy of regulating inside dealing.

There should be a legal definition in the introduction of your thesis. Then, you can discuss when this act is legitimate and when it is illegitimate. After that, you can look at loopholes such as proofing and civil or criminal punishment.

The problem of the regulation of insider dealing has taken several stages in developed jurisdictions. In the first stage, an insider was only one who possesses inside information due to his status or profession. Then the net was widened; the relatives were included as insiders. In the last stage, the term included all those who possess inside information. How did they possess it? From a friend, overhearing it in a café? From someone who by the nature of his employment (for example an electrician) heard the information? He is not from the company but is an insider. Widening the concept of the insider in several stages should be represented in your thesis in a way which reflects the legislative development of this point. The harm in this act does not depend on whether the insider is someone from the company.

INTERVIEWER: What about the SCA regulations in this point.

INTERVIEWEE: Under the SCA regulations only those who possess information because of their status or profession can be insiders. There is another Article...which states that a person cannot derive personal benefit for himself or someone else, but we cannot say that relatives can be included in this Article... But if we widen the net to the third stage, it will include those insiders due to their status, profession, relatives and anyone else.

INTERVIEWER: What do you think about the limited nature of the rules in the SCA?

INTERVIEWEE: There should be a wider net for determining insiders, especially in our societies. In our culture, information is disclosed easily. Also, in companies in this country individuals have positions on several boards of directors. At the same time they are investors in securities. The information is easily passed and everyone can deal on the basis of it. It is also easy to evade the rules if they are limited. An insider can deal in his wife's or children's accounts if they are not included in the regulation. He can also deal in the account of his company, or pass the information to a friend and then share the profits. This can be found here more than anywhere else. The nature of relationships in this society determines that there is insider dealing in this country.

I agree with you in the last point which you will reach it at the end of the research. It is difficult to proof such an act, although it can be easy to find substantiations that the act was committed. This is the most difficult case to be proved amongst the market misconduct.

There is certainly insider dealing activities. It is also because a lot of the companies in this country have a family characteristic, in spite of their transformation into public companies. Member of the board of directors can be relatives. This makes it easy to pass information from one person to another.

Insider dealing is a crime in developed countries and should be considered so. In the SCA regulations it is also considered a crime.

INTERVIEWER: If the developed countries widened the definition of an insider step by step, should we also widen it gradually?

INTERVIEWEE: Not necessarily. We take several stages. We should begin where the other has arrived. There were loopholes in the legislation in other countries; we do not have to make the same mistakes.

INTERVIEWER: Should the prohibition be at a federal level?

INTERVIEWEE: Yes, there has to be a federal law issued to criminalise insider dealing. The definitions should also be contained in the federal law.

INTERVIEWER: Did you make any proposals?

INTERVIEWEE: Yes, we have a proposal for amendments to the federal law. It contains a definition of the insider. It also prohibits insider dealing.

The other important point is the definition of material information. A lot of jurisdiction differed in preferring 'inside information' or 'material information'. I think that material information is different than inside information. Inside information should be material information. A piece of information should be material and non-public to be considered as inside information. Not any information that is non-public can be material.

Material information affects the price, the reputation of the issuer, increases or decreases the volume of trading. Any such information is called material. There can be a lot of instances of the materiality of the information. Yet the common thing is that the information affects negatively or positively the price and the volume of trading. This is the common characteristic in all the instances like profits, losses, fire in the company, a new major contract, new production line, expansion plan or a strategic investor entering. All these instances are events or news, but are material because they can affect the price or the volume of trading of the securities.

If the rule states that the information may affect the price, in the financial law 'may' is most probably to happen. If there is news that a company negotiating the establishment of new product line, the other day prices of securities will directly increase. We say that it can affect, but from the view point of the investors it does affect.

In law we introduce a test of normal person or investor in the normal circumstances. But in reality investors directly respond to information. Especially short term investors who do not wait for the dividends. Long term investors may have another strategy they may think that even if there is difficulty in the company it will be solved. They may even prefer dividends over quick speculation. The kind of investors is also determining.

All the definitions of material information in any jurisdiction try to introduce a test. The main point is that material information affects the price and volume of trading of the security.

Materiality is one condition of inside information.

When is information considered to be non-public? It is supposed that information is considered public when it reaches the public.

Inside information is information that is material and non-public at the same time. There can be non-public information which is not material. For example, a member of the board or an executive member is leaving. Investors may be not concerned about this event.

INTERVIEWER: This can be material.

INTERVIEWEE: Yes, it can be in other countries where they differentiate between the capital and the management. However, in our systems who has the capital will be directly a member of the board and he will have authority on the company. The importance of efficient management is unobserved. In other jurisdiction investors are concerned with the management and it is material event if a director is leaving a company. In our jurisdiction there is no distinction between the capital and the management. Major shareholders control the company, forgetting that there are other minor shareholders.

INTERVIEWER: What if the information disclosed in accordance with the disclosure rules.

INTERVIEWEE: In this case it is public and it cannot be said that it is inside. But from the time where the information was actually present until it is properly disclosed, the information is considered non-public.

This happens as follow; an internal auditor checked the financial statements and sends the report to the board. They in turn send it to the general meeting to decide the dividends in there is profit or otherwise. In the period between the times when the auditor reached the results until the time where it was disclosed in the general meeting, the information is considered non-public.

The same is right where a company negotiates establishing a new production line. From the beginning of the negotiations until disclosing the contracting, the information is considered non-public.

This is also a problem in our jurisdiction, which is the disclosure of information to the media before an official disclosure to the regulator. This is dangerous. The news may be published inaccurately and differently from one section of the media to another. It may also be written in a certain way, or a part of the information which does not reflect the whole may be given. On contrary when the information is disclosed to the SCA it will disclose it precisely to the public.

INTERVIEWER: There is a loophole in regulation in this area. In other jurisdictions there are rules applied which regulates how the issuer should deal with the media. What do you think?

INTERVIEWEE: Probably yes. The problem is disclosing the information to the media. Sometimes there is contradiction in the news or even confusion. The next day the company approve or disapproves the news. From the time such news is published until the company officially is requested to comment, there would have been dealings on the basis of such news.

INTERVIEWER: This is a fruitful area for manipulation.

INTERVIEWEE: There should be obligation on the media to obtain such information only from the regulator. Therefore, there will be one official source of the regulatory information. The markets also should pass the information to the SCA not to publish it to different recipients.

In fact the journalists try to reach the information. They take words on the tongue of directors and executives. Everyone writes the information as he perceived it. There may accurate reporting only through the regulator. It is different when we say a company intends than the company looks to. Negotiation is different from contracting.

It is difficult for the SCA to intervene in the work of the media. They should have code of ethics. This type of news may affect the economics of the country. They should take information from reliable sources.

INTERVIEWER: In other jurisdictions there are regulatory news agencies.

Yes...

INTERVIEWER: Researchers and analysts also should not be allowed to misuse the information.

INTERVIEWEE: In the proposed law, all the analysts, researchers and advisors have to obtain a license from the SCA to conduct such activities. They will be required to prove their qualification and experience.

INTERVIEWER: Researchers also should not be allowed to selectively disclose the information.

INTERVIEWEE: In research there is either selling advice to a certain client. In this case the investor takes the decision to buy or sale. The decision is not taken by the financial advisor. There also can be a service where the advice is contained in research, studies and recommendations. In this case it should be states that it is only advice. It also should be declared that the researcher has no direct or indirect interest in the securities under study. What happen in this country is that advisors recommend buy or sale while they are dealer in the same securities. Or they may act for the benefit of a company. There is conflict of interests in these actions.

In the analyst or researcher takes the investment decision he will be an investment manager...

...

INTERVIEWER: There is a gap in laws in this field, there is no law regulating funds for example.

INTERVIEWEE: The reason is that we have emerging markets. The SCA and markets were established in 2000. There had been unofficial dealing in securities of public companies from long time ago. People used to deal in securities in face to face dealings, where they sign contracts. The same way is still used in IPOs... The legal regulation came in a late stage.

In the same way the French bourse was established. Dealers used to deal in contracts of securities in a cafe. The regulation has taken several stages.

The law regulates transactions between individuals which mean that transactions may exist before the law...

The subjects of funds, financial advisors and financial managers were regulated by a Central Bank law. This law was introduced in 1970s.

In the new law the SCA has obtained all these authorities which were transferred from Central Bank to the SCA. It has the authority to regulate the services of funds, financial advisors and financial managers. It also has the authority to regulate IPOs following the transfer of authority from the Ministry of Economics to the SCA...

...

INTERVIEWEE: You have to make it clear when the act of insider is legitimate and when it is not...

We have a procedure where the insider has to obtain a permission to deal in the securities of his company. If he possessed inside information, but obtained a permission and dealt in the securities. It will be easier for the SCA to

discover that he dealt on the basis of the information. The permission does not mean that the dealing was legitimate, on contrary it is a procedure for watching insider dealing.

There is also a procedure where insiders are not allowed to deal in a certain period prior and after the disclosure of financial statements... In this case dealing is never allowed and there is no permission given...

There is also a procedure where trading will be brought to a halt when a public or a board meeting takes place. So information does not leak causing distresses dealers.

These are soft law procedures where the doubt is deleted.

((Soft law may be more efficient than the main prohibition and enforcement. If anything is barred it will be by the soft law. Prevention is better than cure))

It is always in any law following a period of application, the shortcomings are discovered. The vision of the first law expires and then a new vision for several years should be placed...

Each time the regulator in any new law demands for more authorities...

INTERVIEWER: There is contradiction in the SAC rules in defining inside information.

INTERVIEWEE: They referred to 'unpublished information' and 'undisclosed information'. In the proposed law we use 'inside information' and there is also a definition.

INTERVIEWER: Would you tell me from which jurisdiction have you compared the proposed law, please?

INTERVIEWEE: In fact it has been a comparative study between several jurisdictions. Each part is compared to a different jurisdiction. For example in regards to IPOs we benefited from those jurisdictions where they regulated it. In consideration to funds, we only delegated authority to the SCA to regulate it because it is wide area with so many details. There are only basic definitions in relation to fund... in relation to other financial services...

INTERVIEWER: It is difficult to imagine how the current law could be applied. Inside information and insiders are mysterious.

INTERVIEWEE: Yes, I agree, there is no definition.

There are two factors; information which is not published or not disclosed and insider who possesses the information due to his status.

They used 'or' between the two terms. It means the two terms are synonyms.

Disclosure usually is done to the SCA or the markets who in turn discloses the information to the public.

But I think that the two terms are in fact different. Disclosed information is not necessarily public information. The information may be disclosed to the SCA and yet not made public. In relation to material information there is a certain procedure where the issuer has to release it to the press. Non-disclosed in a narrower circle than non-public.

In other jurisdiction they state to inside information synonym of which is confidential information. As I remember this is in France and the US. Confidential means that it has not been disclosed even to the regulator. But most of the jurisdictions use inside information.

There is no definition of the insider...

Insider is only who possess inside information due to his status...

In disclosure requirements, there is also a rule prohibiting insider dealing. Board of directors, employees...

INTERVIEWER: Have you got an idea about DIFC?

INTERVIEWEE: The laws of the DIFC are different from that of the UAE jurisdiction. It is a free zone and treated like being outside the UAE jurisdiction...

...

I think that it should be inside the national jurisdiction...

INTERVIEWER: Have you any cases of insider dealing.

INTERVIEWEE: There is insider dealing activities in all the markets. However, the case must reach a level where a prosecution can be sustained.

Some jurisdictions found that it is difficult to prove a criminal case, they turned to administrative penalties.

If there is no significant loss in the market, they usually investigate the case and apply an administrative penalty.

There is no case of insider dealing in the UAE. Only suspicious dealings were investigated. No case was prosecuted, because in needs assurance that there is sufficient evidence. The SCA cannot prosecute it should pass the case to Public Prosecution...

There is also an issue of expertise. It is difficult to discuss with lawyers technical points. We should give them legal evidence regarding the subject.

Proving insider dealing is tricky. The difficulty is in the fact that the investigation is based on technical evidence taken from trading system. This is compared with the inside information. Who do you know that someone is dealing, etc. It is all known from the trading system, dealings, dates, orders, etc. This is all technical subjects. At the same time there is inside information and insider.

Now you have got the person. The information from the system. You have got to prove that there was inside information. The first technical point is easy for regulators, but the difficulty is in the next point. It is especially difficult to prove that a tippee was the insider.

In all the jurisdictions the 'intention' was assumed.

...

The main point is the intention to achieve a personal benefit. The objective of insider dealing is achieving a benefit either by making a profit or avoiding a loss. This is the difficult point; it is more difficult than proving the insider status and his possession of inside information.

The insider's knowledge of the nature of information is easy to be proved. We can know all the details in regards to the insider from the dealing system. We know if someone traded in any time and who is he. Volume, time, date of the dealings and whether they took place before or after a meeting can also be easily proved. We also know when the information was disclosed to the SCA.

It is only the link between the disclosure to the SCA and the time of dealings. Some influents can deal and delay disclosure two or three days. It is necessarily that the dealing is followed by disclosure.

The date of disclosure and the date of dealings are all circumstantial not definite evidence.

The court also scrutinizes the objective of achieving a benefit.

INTERVIEWER: Do you think that a criminal prosecution is efficient?

INTERVIEWEE: It is efficient if there are judges specialised in this sort of cases. He must understand the techniques of trading to understand the evidence...

INTERVIEWER: Other jurisdictions found it difficult to depend on criminal prosecutions.

INTERVIEWEE: ...

INTERVIEWER: Sometimes it is difficult to see any benefit achieved from insider dealing, e.g. tipping.

INTERVIEWEE: This can be dealt with by introducing options, fix penalty or a penalty multiple of the profit made or the loss avoided... The punishment should be proportionate.

...

...

Achieving a benefit is still a condition under the proposed law.

There was a minor case where a member of a board bought securities. After a period of time he sold them before a disclosure being made. The problem was that the information was positive and by selling the securities in that time he lost a profit. How can you say that this was insider dealing...

INTERVIEWER: There can be tipping of the inside information to a friend without a direct benefit.

INTERVIEWEE: In this case the law requires achieving a benefit for him or for another...

INTERVIEWER: There are economists who argue that insider dealing should not be prohibited.

INTERVIEWEE: Justice requires that regulators are established to provide information for all investors at the same time and of the same quality. There should not be dissimilarity in informing. Is it fair to allow insiders to exploit inside information? Why should other investors lose because of them?

INTERVIEWER: What will the rules do?

INTERVIEWEE: They at least sustain confidence in the markets. It will not give the chance for everyone to exploit the situation.

Interview (4)

Transcript translated from Arabic.

Interviewee: HABIB ALMULLA, Former MP (Member of the Federal National Council) and Former Chairman of the Dubai Financial Services Authority

Place and date: Dubai, August 2007.

INTERVIEWER: There is no clear and precise regulation of insider dealing in the local financial markets in the UAE.

INTERVIEWEE: In consideration to regulation as general, there are two systems in the UAE. **First**, the main system represented in the Securities and Commodities Authority. It is dedicated to regulate the financial markets in the UAE which in turn are three most important markets; Abu Dhabi Securities Market, Dubai Financial Market and Dubai Gold and Commodities Exchange. The laws and regulations of the SCA have been issued without prior rigorous study. The drafting team constituted non-specialists in financial markets and securities regulation. The laws were issued with no comparison with the laws and regulations in financial markets in developed countries. This fact resulted in our not benefiting from the experiences of other jurisdictions and we wasted a chance to avoid the shortcomings of such jurisdictions. There are legal and judicial precedents which could have been beneficial if considered in drafting the new law. Introducing details of the new law should also have been considered, because there are no judicial precedents which can be used as directions by the courts. As a consequence, all these factors caused the issuing of superficial laws.

In addition, the fact that the markets existed prior to the regulator was an extraordinary situation. In contrary to other jurisdictions where the regulator is initially established and in turn it authorizes the markets. Consequently, as a matter of fact the SCA has no actual influence on the markets. Although the SCA tried to alter the situation through issuing regulations, but they were issued surface without comprehensible details. Therefore, it can be said that the SCA has no actual influence on the markets. On this basis, when discussing insider dealing, there is no clear and comprehended handling of the issue.

Second, there is another limited system which is the Dubai Financial Services Authority the regulator of the Dubai International Financial Centre. In laws and regulations of the DIFC were watchfully drafted, benchmarked with best practices and in accordance with international regulatory standards. The laws and regulations of the DIFC represent a high standard equivalent to the leading international financial markets regulation. The particular problem is that there is no actual activity in the centre. More precisely, there is a limited volume of trading and it is incomparable to the local markets in the UAE. Thus, it can be said that there is activity regulated by no law and there is law regulating no activity. It is also right that the laws and regulations of the DIFC have not been examined except to a certain level.

INTERVIEWER: Do you agree that the SCA is inefficient?

INTERVIEWEE: The influence of the SCA is made up by the authority delegated to it by the law. Such authorities include adopting and enforcing regulations which aim to protect investors and the dignity of dealings.

INTERVIEWER: It is easy to transplant best laws and regulations from other jurisdictions, but is it easy to enforce such laws in the UAE? Since the culture and business environment is distinct to the source jurisdiction.

INTERVIEWEE: The most important point is determining our goal first. We have to decide whether we aim to establish an international financial centre or we want to be satisfied with local markets. The last are contented with

listing securities of local issuers and providing investment opportunities for local investors and debtors. However, regardless of aiming to establish an international financial hub, there should be improvement in financial market regulation. At least there should be obligations on public companies. Authorities should not be lenient towards public companies, because they invest in public's money.

In general, there could be gradual change by allowing periods for companies to change their standings to meet the new requirements. Leaving the current situation is incorrect, it should be altered.

INTERVIEWER: Do we aim to be a financial hub in the UAE or especially in Dubai?

INTERVIEWEE: To a certain extent there is aiming to be a financial hub. However, we have not taken serious steps towards this goal. There is a trend to develop the role of regulators like the Central Bank and the SCA and to determine their authorities. Yet it needs a political will to achieve tangible results.

INTERVIEWER: What made the laws and regulations of the local financial markets in the UAE backward especially when compared to the laws and regulations of the DIFC which also exists in the UAE?

INTERVIEWEE: It is difficult to change a Federal Law. This comprises the difficulty in developing regulations and the competent regulators' role in the UAE. Federal legislation requires considerably longer time and more difficult to be adopted. This is because of the complicated legislative bureaucracy and procedures.

INTERVIEWER: There is uncertainty in the regulatory system in the UAE. In some areas it is not clear whether it is a self-regulatory system or a statutory single regulator system.

INTERVIEWEE: They do not have a clear observation of the most appropriate system. There should be benchmark to the developed countries and adoption of the system suits the UAE.

From my point of view, the system of a single regulator is more appropriate to the UAE, because it is a small federal country. The existence of more than one regulator for banks and financial markets causes overlap in authorities.

In general, the system of SROs in the US is gradually changing towards 'coding' regulations. The fact of the matter is that the leading international financial markets flourished in Common Law jurisdictions, especially in London, New York, Singapore and Hong Kong. The European markets are incomparable to those of the US and the UK. To benefit from other jurisdictions, it is better benchmark to the UK system than to the French system. Regardless of establishing a financial hub, we need to protect investors and the dealings to an acceptable extent which protects the markets and economy of the country. It is not erroneous to benchmark the new laws with best international practices.

INTERVIEWER: Are the rules of the SCA clear in regulating insider dealing on the basis of non-public material information?

INTERVIEWEE: The regulations of the SCA does not clearly prohibit insider dealing. There is only some rules dedicated to brokers and boards of directors. There has to be a clear and precise definition of insider dealing. There has to be clarification of the acts which are not prohibited. A precise perception of the act should be introduced. There has to be a clear formulation of the prohibited act.

The law was drafted by a team of non-specialists. It is weak and surface. There was no benefiting from the experience of other jurisdictions. There is a legislature gap. The current law is unclear and difficult to be interpreted and enforced by the courts. In addition, the courts are unaware of the nature of this kind of new cases.

It can be said that there are no legal rules accurately drafted to face the problem of insider dealing. There has to be administrative penalties. There have to be civil remedies. Proper authority should be given to the SCA.

INTERVIEWER: Do you agree that specialized courts should be established to hear such new financial cases?

INTERVIEWEE: As a general principle the judicial authority has to be respected. I disagree with removing jurisdiction from the general judiciary in every new situation. Removing jurisdiction from the general judiciary is admitting its weakness. On contrary, judiciary should be developed.

I would prefer constituting specialized circuits in courts to hear new complicated cases. Market abuse is wider than insider dealing and can be dealt with in the same way.

We have to benefit from the experience of developed countries in financial markets. We can take from one law or combine between more than one law to reach a law which suits us and implements international standards. We take the principles not the law as a whole.

Amendments to law may take several years and may collapse due to legislative bureaucracy. It is appropriate to benefit from the experience of other jurisdictions. The existence of the DIFC with a completely separate jurisdiction is a bold idea to develop financial markets. Part of the solution is better than no solution.

In the area of disclosure there is also a legislative gap and no clear rules.

INTERVIEWER: There are legal principles which are unacknowledged in UAE jurisdiction, but such principles are central to financial regulation in developed jurisdictions, For instance, conflict of interests and Chinese walls. How can we deal with this problem?

INTERVIEWEE: There has to be a completely new law. We need a radical change in legal principles and understandings in these areas. There is a need for similar laws. These are essential principles in developed jurisdictions.

Laws and regulations of financial markets can be developed. We need political will and a clear plan towards a determined objective.

Interviews (5), (6) and (7)

Original interview transcript in English.

Interviewees: Anonymous 1, 2 and 3, Dubai Financial Services Authority

Place and date: Dubai, August 2007.

Interviewer: The first question is why we need an international financial centre in Dubai while we have other local markets.

Anonymous 1: The reason why a separate financial market was created was that there is no financial market between Singapore and London that is aligned with international standards. What we do have is some local regional markets; none of these markets operates in accordance with international standards. So the intention of the ruler of Dubai was to create an international market to act as a model of best practice in the region for developed capital markets. Obviously, for the development of capital markets investors look at how safe in their investment, the rules that regulate the investment and the law that underpins the legality of the investment. How they can be enforced. When they look at the regional markets, unfortunately, regional legal systems are not the same that you will find in London, New York, Singapore and Hong Kong. The idea was to create a centre of excellence for the development of capital markets based on the best international models in terms of financial services regulation. We really act of the leader for change in the region. Because we are a model of what the regulation of financial services will be. Hope that by being so close to other financial centres within the region that they would also raise the bar to the standards that we impose on our financial services and institutions.

Interviewer: We have a weakness in the local financial markets regulation, how can we benefit from the rules and regulation of the DIFC?

Anonymous 1: The DIFC was created as a financial free zone. All the commercial and civil laws of the UAE has been exempted. The criminal law has not been exempted, so it still applies. We have been able to create some civil measures to protect investors in the centre from people that are engaged in insider dealing. But we can only enforce civil fines for example. In relation to such crimes, the criminal element has to be reported back to Dubai courts through Dubai Public Prosecution who then take the criminal action it is not our business. We kind of work on a two peers system, we have the UAE criminal system which still applies to the centre. The UAE penal law has penalties relation to insider dealing, even though there are not very well developed rules as one expects in international level. From the civil perspective we have obviously adopted what meets international standards in relation to insider dealing.

Anonymous 2: To answer your earlier question. Capital markets flourished in circumstances where there is good law and consistency in the application of the law. There has not been in the UAE generally and in Gulf Council countries a well-understood international law that international clients could comply with. The jurisdictions vary from Gulf country to Gulf country and within the UAE generally. In order to attract capital back into these markets there needs to be a system of law that is easily understood and consistent with other systems in other jurisdictions around the world and can easily be applied. There is an organization called IOSCO, they set benchmarks in terms of legal standards that they want to see implemented. These benchmarks are well established in most reputable jurisdictions. In those circumstances, capital is generally attracted to those markets. The purpose of establishing this jurisdiction is to develop our standards and legal certainty to a level equitable to reputable jurisdictions. This attracts capital to the market.

Anonymous 1: I think in one side it is to attract the capital, but this is half of the side. The other half is to bring here the expertise to develop the capital that is here right now which is sinking. There is lot of private equity deal; there is adventure capital and new fund here. This is all channelling. Capital that is right now here not capital from other regions. There is a foreign direct investment purpose, but not as much as to develop the capital market in the region which has not been done yet.

Interviewer: The legal jurisdiction of the centre is based on English Common Law while the jurisdiction of law in this country is civil law based on Egyptian and French law with some aspects of Shariaa law. Does not this make any difficulty?

Anonymous 1: not really, because we operate as a free zone, so we operate within the boundaries of our zone. We are just a centre of excellence. We are aligned with other international financial centres. If you look at them, you find that they based on common law, e.g., New York, London, Singapore and Hong Kong, which are the four major financial centres in the world. Our jurisdiction is based on common law, which means that investors that already trading at that kind of market are ready to meet this standard, the legal regime and the rules and regulations that we also impose in our centre. For an investor it is easy to come and invest here. The same is true for big financial institutions that will be trading in London and New York. They kind of know the regime. That is why we adopted the common law system in the centre.

Anonymous 2: Many of the laws that apply in most sophisticated capital markets have many similarities. For example, your securities law and collective investment law are not dissimilar. Your corporate governance requirements, for example, are not dissimilar. They are common from jurisdiction to jurisdiction. There might be some discrete differences, but in the main, most of the laws are very similar. Thus, firms and individuals who are actually in the market are mostly comfortable with this sort of legislation.

Anonymous 3: In fact, I think that when it comes to primary legislation, it does not matter much. When there are differences, for instance, if you compare between the regulation of insider dealing and enforcement in UK, US and Germany. I think you find a lot of similarity. In fact, you might find indeed different approaches in how to deal with an actual case. You might find differences in secondary legislation. I think the differences are marginal. I think it comes in fact to the effectiveness of the supervisory regime. You rarely look at the court to report a problem. If there is a problem, it is ensuring the prevention of insider dealing or the spread of inside information. How do you do that and who is closest to the source of information? That is naturally, I would argue, the financial services regulator who imposes certain restrictions e.g. Chinese walls, code of business and implementing a regime of best practices as regarded by IOSCO. This should be supported by a strong criminal regime and sophisticated investigators know how to investigate in such a case. There should be a basket of appropriate penalties available. I think if you drill it down to the court, it much lies in strong regulatory requirements.

Anonymous 2: It is important not to have just good laws and rules being placed. It is even more important that these rules are going to be applied and there will be a standard of regulation that is respected. The financial systems are built primarily on their integrity. Once they lose their integrity you may find that there is a collapse in the financial system. If you look at the not-so-recent big collapses in the US during the last ten years, the effect of that was a disruption to the confidence in the system. So governments said about that we rebuilding that confidence by implementing tougher restrictions and then complying a new regulatory enforcement regime. That has effect of rebuilding confidence again in the system. But it also brings a very significant cost on the firms that are required to implement these new regulatory burdens. So governments have responsibilities to ensure this tied off proper balance between an appropriate standard that ensures confidence in the market and on the other hand to ensure that the cost is down the benefit to the people participating in the market.

Anonymous 3: From here say I heard that it is nothing unusual still that people sitting on the local boards of publicly investing company here in the UAE, from board meetings where decision is made, pick up their phone and call someone to inform about a certain investment decision for them. It is just to share. They have no feeling of anything wrong with it. This how they say the market used in this region about thirty years ago. You share information and this is basically trading information. I think there is a longer history of these rules and regulations in the US or the UK. There is transition period and we come back to the question why this centre is here. To provide a certain period of education and setting the benchmark, this is say that governance standards, business ethics and Chinese walls. Governance structure within the firm has to be of a certain standard.

Anonymous 1: I think that it needs time to change a culture and to change understanding. All emerging markets trade in insider dealing and market rumours. It is just because they are not sophisticated markets. It is only once the markets get sophisticated, and then investors, board members and companies become more aware of what are the regulatory requirements what the implications requirements are. You can have a lot of really good law, but if no one enforces these laws then they are useless. I think that when markets become more sophisticated and when you compete on the global financial services market, people expects you to meet those standards. If we are the DIFC because we claim to be a major international financial centre, if we did not enforce the standards that we have, investors will not come here and take it seriously. If we do it out there in Dubai that is really a local market, so international investors do not have such a great interest. But when you say that you want to open up the Dubai market, the rest of the world will be looking at you. If there is insider dealing activity they say, 'why are you not doing anything about it? You are advantaging other investors over me, so I am not going to invest my money there. It is the question of who you are targeting, who is your audience and where the capital coming from. On the basis of that you decide how strong rules and regulations are.

Interviewer: Are the rules of the centre directed to collective investors only?

Anonymous 1: No, we cover all sorts of financial services, insurance, banking, collective investment schemes, corporate finance and reinsurance. Collective investment is just one of financial services.

Interviewer: Do you cover individual investors?

Anonymous 1: Absolutely, an individual has to have a minimum of one million liquid networks to be able to qualify as compliant.

Interviewer: As a registered person or a registered company.

Anonymous 1: We have a registrar of companies that looks at the incorporation of all companies in the DIFC or the registration of foreign branches.

Anonymous 2: Companies can incorporate in the DIFC to undertake business activities. Some of those business activities are regulated business activities and some of them unregulated. The unregulated activities would be Starbucks and some of the restaurants. The regulated activities are those which provide financial services. So, if you apply for providing a financial service within the DIFC, you required to hold a licence to provide that service. You can only get that licence by applying to be assessed against a certain benchmarks to ensure that the firm itself and the people working at the firm at fitting proper to carry up business activities of the license they conduct. That license would be to conduct business within a certain category. There are five financial services categories and in each category the firm is authorised to do certain activity. For our purpose the centre supervises them to ensure that they are complying with the law...

Anonymous 3: When we find an employee using information from the firm and we find that this person has made wrong doing, we see the consequences on the criminal and civil side of the law and we will disqualify him from working in the centre again. If we found also the there is a major failure by the firm in overseeing the activity of this person, we also can take action against the firm.

Anonymous 2: So I understand that your thesis will be looking at the effectiveness of the regulatory regime surrounding insider trading and market abuse. In that case you will be looking at the laws relates to insider dealing at the DIFC, but you also need to look at the criminal law of the UAE and its effectiveness in deterring this sort of misconduct.

Interviewer: Preliminary, the subject was about insider dealing, but when I came to discuss it there was a great deal of looking at the regulation as general in the country. So if regulation as general is not improved, there would be no improvement in regulating insider dealing.

Anonymous 1: I think there is some improvement you have to look at the regulators F code not created so long ago. There is continues improvement, because obviously by having a centre like the DIFC it enforce everybody else to raise their bar and look at what they are trying to do. Dubai may be more soured that Abu Dhabi, because Dubai is a place that is very visible on the international scene. Dubai is so much out there in the global market. It is investing outwards and trying to attract capital; it is trying to improve its laws and regulations. The problem is that this is a federal system. Not everything can be done by Dubai alone; it has to be done at federal level. So, the banking system is very much behind the international banking system. It is still underdeveloped, even though it is

improving slowly, but there is a long way to go before it matches one of the international banking systems. If you look at the US and Europe, there is a constant development. How far things happen and how effective they are that is a matter for you to be researched. It still an emerging market, you have to remember that. In all the emerging markets there is a common trend and it takes time to improve. I think the problem is not just hiring the best laws from, it goes down to mindset. We have local firms here that found it very difficult to implement our rules and regulations, because there compliance officers are not really that good. If you are compliance officer and you work in London for 10-15 years, compliance is in seconds you pick up the rulebook, understand what the requirements are and you do it. When you do not have that compliance culture, when the senior management do not have the compliant culture, it becomes very difficult to them to set the culture all the way from the lower level up to the board. So it is a mindset that you have to change.

...Dr Saidi

...

Anonymous 1: Bourse Dubai is a holding company, which will own the DIFC.

Anonymous 2: It is DIFC incorporated holding company that holds the government's interests in the Dubai Financial Market and the DIFX. Now, the interesting aspect of that is should there subsequently be a merger of these two markets. If that were the case, how would those entities be brought together? Where will the entity sit and where will the market be? Who would regulate the market how would insider trading activities on that market be regulated. What would be a good law and what would be a perceived law? How would we regulate a conduct by an individual outside the jurisdiction of the DIFC? There are interesting issues that you may want to examine in your thesis.

...

Interviewer: Can we discuss Markets Law, DIFC Law No.12 of 2004, Article 42, please?

Anonymous 2: Our rules relate primarily to market abuse rather than insider dealing specifically.

Anonymous 2: First I want to tell you about insider dealing in the commodities market. We have two types of markets here in the DIFC; we have a commodities market and a securities market. Commodities are derivatives, so we can refer to it as the commodities derivatives market. The DIFX is seeking licensing to run a derivatives exchange where options and futures relating to financial instruments are dealt. A person, who trades on inside information in relation to commodities trading, would not be prosecuted, because there is not really an offence of insider dealing in relation to commodities trading. All commodities traders effectively deal on inside information. They have information about the market, and they have information about the supply of a particular commodity and the demand for a particular commodity. In relation to commodities trading, there is no offence of insider dealing. However, there is an offence of market manipulation, because entities in the market are able to manipulate the price of commodities, depending on their ability to supply more products or to reduce the supply of products.

Interviewer: In some jurisdictions attempts were made to make it an offence to deal in derivatives on commodities on the basis of inside information. Do you have any ideas about this?

Anonymous 2: I am not aware of this. In the US there is no crime of insider dealing in relation to commodities trading, because the basis of this kind of trading is that all traders have inside information, so they actually trade on this information on a daily basis.

In relation to securities trading, however, it is more proper that one can use inside information to manipulate the prices to a wider extent. One can also manipulate the market. So I think we have two offences: those of market manipulation and insider dealing. But there can be insider trading in derivatives on securities market.

Interviewer: The rule is different from other rules of the UK, Europe and the US.

Anonymous 1: ...What is the difference...

Interviewer: It uses a 'reporting entity', it is quite unusual to be used.

Anonymous 1: But there is a definition...

Anonymous 2: it is a term that is specific to our legislation.

Interviewer: What is the difference between an issuer and a reporting entity?

Anonymous 3: The term is used here to describe a reporting entity, because we use so many terms already. So if we had used 'issuer' it would have been too short. 'Reporting entities' indicates to financial services providers that are obligated to report to the exchange or the regulator.

Anonymous 1: The reporting entity includes the issuer. A jurisdiction may state that insider dealing provisions only deal with issuers. Ours is actually wider. So it captures a wider group of people, because the issuer falls within the term 'reporting entities'.

Interviewer: Does it include funds, because fund managers are not issuers?

Anonymous 1: It could be the operator of a fund. Because a fund is not issued, a fund is managed. A fund is not an issue, but you have the issue of a unit in a fund.

Anonymous 2: The interesting point I take here is that insider trading provision applies to reporting entities...

There may be individuals who are not reporting entities, who could potentially be in position to undertake insider dealing activities. The question is if they are excluded should they be excluded?

Anonymous 1: No, because we have in Article 43 that he shall not provide anybody else with inside information. The prohibition on dealing is only on people who have direct information and then you cannot pass the information to anybody else. It is an offence for them to pass the information... a reporting entity or a person in a special relationship with the reporting entity...

Article 43...

Which means that the main obligation is on the reporting entity or people contact it. But you cannot ask somebody else to deal on the basis of that information to deal on your behalf.

Anonymous 2: Having the inside information is not an offence and sharing the information with a colleague is not an offence. Because that sharing is undertaken by way of business in ordinary circumstances. It is acting upon that information. For example, next week we are trading a particular product.

Anonymous 1: But you can only inform somebody else in the normal course of business. That is, if you have a lawyer or an accountant. You can not inform your wife or mother and tell them “by the way, we going to be selling 50% of the shares in the company because the results have been really bad”. That would actually be in breach of our law. But if you call your lawyer and say “I need you to prepare a study for me because we need to perform a certain act”. This is in fact what happens in companies. Then the lawyer should keep the information confidential.

Interviewer: Do they obligate issuers to prepare insider lists when they disclose information in the normal course of action?

Anonymous 3: There is no requirement in our law for a list to be kept. But it will be good practice to keep it.

Anonymous 1: There are also definition of what material information is and who is a person in a special relationship.

Interviewer: What about important information e.g. takeover bid. Is there an obligation of keeping a list?

Anonymous 2: Not sure.

Anonymous 3: Internally, in that process you have for example in investment banking unit who works on a deal of takeover. Say that you have colleagues on the same floor who are in the private banking side. We have requirements to have Chinese Walls between these two units just to prevent reaching the information to the private banking side. ‘Your good clients tell them to buy in X there going to be takeover on the share’. These requirements are also found in COB under the business rules.

Anonymous 2: What you may also find is that a lot of our laws are principle based. They do not have the same level of description that you may have in some more mature jurisdictions. Where there may have been more instances of this kind of offence occurring and there has been more time to make imminence and to enhance the laws in relation to this particular offences. You on some circumstances see that our law in principle based and not descriptive.

Interviewer: Would you explain ‘principled based regulation’ more, please?

Anonymous 2: Some jurisdictions operate on a risk basis as we do. The UK at the present time is trying to move towards principle based approach to regulation. I think the whole intent is that it is very difficult to capture in descriptive terms all the range of legal and positive conduct that you need people to comply with. But it is much easier to provide broad principles in which you want them to adhere to and regulate on the basis of principles. What you find is if you are a prescriptive regulator you rulebooks just continue to grow. Until you get to a stage where it is almost impossible to comply with the rules because they so descriptive and on occasions they can conflict with each other. Principle based regulation is adopted because it is easier approach to both the users and the regulators.

Anonymous 3: I read that the German regulator aim to go into principle based regulation because they want to reduce the number of pages to 8000. So after that exercise there will be 8000 pages of rules and guidance left which should support those principles...

Anonymous 1: It is also because we are a wholesale centre; we do not require such equal law, because we do not have to protect retail investors. Things may change in the future when we decide to allow retail investors; we will have to provide for a number of protections and disclosures in relation to these individuals, which is why it has been easier for us to have principle based regulation. Having said that, however, it seems that in the world currently in the financial centres there is a trend towards more principled based regulation. The US just announced the creation of a single regulator which will actually combine two regulators and will be principle based regulator. I think the world moving to that, it remains to be seen who difficult it to implement principle based regulation, and because this depends on the firms who are they are. For example in this part of the world if you ask me principle based regulation is difficult to implement because people do not have the culture and understanding of what is required. If we draw a nice principle, but if they do not know what you need to do to implement it, it becomes very difficult to implement it. If we have very prescriptive rules in a market that is not so familiar, people will say I have to do a b c and d and then I have complied with the requirement.

Interviewer: Having guides under the rules is not contradicting with principle base regulation.

Anonymous 1: Guidance is not binding; it only explains what the rule is. When you have a rule you need to do this, guide gives an example if you do it this way that will be complying with the rule. However, because it is guidance and it is not the rule, you can say to the regulator look I want to do it differently because it suites my business better to do it this way. You sit down with the supervision people and the authorization people and explain why you are adopting a different approach. They may say very well we are satisfied with what you do.

Anonymous 2: Various jurisdictions deal with guidance differently. In this centre guidance accompanies the rule. You find in other jurisdictions that they issue policy papers they may call them different names, which actually provides guidance on how the rule is interpreted.

The other thing in principle based regulation is that governments move towards principle base regulation or needs to be prescriptive. It is generally depends on the economic circumstances. When things are going well, governments have a tendency to move towards principle base regulation. When there are major economic or corporate collapses within the jurisdiction, the government moves to be more prescriptive.

All the rules are put in place not just to regulate a company individually; they are actually to facilitate business. At the end of the day, that what these rules should be all about. They should be assisting business.

If they get to the stage where the cost of compliance is greater than the benefit they supply, then the rules need to move back. In most jurisdictions around the world the cost of compliance is too large. In jurisdictions such as our

own at the moment, you will never here that argument. You will never find a conference where they talk about the cost of compliance being too large. They only say we need better rules and we need better standards. That is because it is an emerging market.

Appendix 7: A copy of part of (App2) of the DFSA Rulebook Offered Securities Rules (OSR)

App 2 CONTINUING OBLIGATIONS

A2.1 Continuing obligations - disclosure relating to the reporting entity

A2.1.1 On occurrence of an event in the "events" column, a Reporting Entity must make the type of disclosure in accordance with the "requirements" column and the "time" column. [Amended][VER2/08-05]

- Note:**
1. A column marked with an "x" indicates that the disclosure requirements apply in relation to that Security.
 2. Continuing obligations in relation to disclosure requirements for Listed Funds are located in section A2.3. [Added][VER2/08-05]

		A2.1.1							
Event	Requirements	Time	Shares	Warrants over Shares	Options	Warrants over Options	Warrants over Shares	Options over Shares	Certificates over Shares
Price Sensitive Information Relating to the Reporting Entity									
1.	(a) material developments relating to the Securities that may constitute Price Sensitive Information; (b) any change in the business, financial condition, performance or expectation of performance that may constitute Price Sensitive Information; and (c) impending or strategic developments or matters in the course of negotiations where there is reason to believe that a breach of confidence has or is likely to occur in relation to Price Sensitive Information.	Market disclosure of the development or change as the case may be, including all Price Sensitive Information relating to it.	Without delay.	X	X	X	X	X	X
2.	Belief that a breach of confidence has occurred or is likely to occur in relation to Price Sensitive Information.	Disclosure to the DFSA of the breach or likely breach including all Price Sensitive Information relating to it.	Without delay.	X	X	X	X	X	X
The Governing Body of the Reporting Entity									
3.	Any change to the Governing Body of the Reporting Entity including: (a) the appointment of a new Director;	Market disclosure of: (a) the effective date of the	Without delay.	X	X			X	

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